4Q 2018

Bank+Insurance Hybrid Capital

With CRÉDIT AGRICOLE CORPORATE & INVESTMENT BANK

GAME OVER?

Markets feel the pain of quantitative tightening, political uncertainty

EBA Q&A
Triggers, calls, UK law

AT1 Roundtable
Evolving dynamics

Portugal
Reaping the rewards

Bank+Insurance HybridCapital

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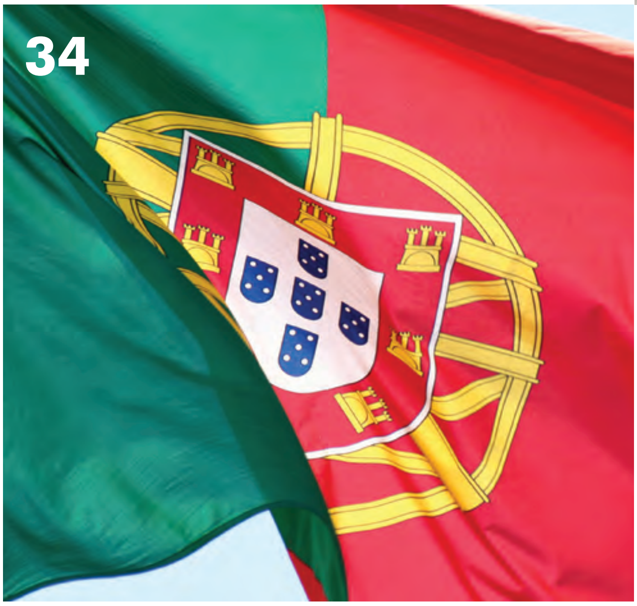

Game over?

Any hopes that UK prime minister Theresa May returning from Brussels with a draft Brexit withdrawal agreement on 14 November would help lift the uncertainty surrounding markets quickly evaporated.

If investors would even turn their backs on a triple-A sterling floating rate covered bond, as they did when approached by TSB the next morning, what hope is there for riskier assets?

Not much, appears to be the answer going into year-end, with issuers putting off plans for subordinated and senior non-preferred trades and taking refuge in (non-sterling) covered bonds or even senior preferred debt at the short end.

Although Mario Draghi appears to be entertaining thoughts of a replacement for TLTROs, the ECB's asset purchase programme will finally end on schedule at the end of the year — despite some late pleas for help from his native country, which has been the cause of so much of the market's recent pain.

Did Italy listen when the central bank president urged reforms while the umbrella of QE was there for support?

Portugal, at least, did, and has been rewarded with a return to investment grade by Moody's. We discuss how banks there are now positioned for issuance with their representatives and other market participants.

The rise in yields and risk premiums is only amplifying speculation about how banks will deal with approaching AT1 calls in 2019, and Crédit Agricole CIB gathered investors and issuers together to debate the possible outcomes, while an EBA official shares insights into the topic, as well as trigger levels and UK law issuance.

Alongside bank capital, the corporate hybrid market is facing a fundamental challenge due to a proposed change in accounting treatment for the most common structure, and in this issue we take a timely diversion to find out if this could spell the end for corporate hybrids.

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Market news

Brexit, Italy prove too hot to handle as deals suffer

A row between the Italian government and the EU over the peripheral country's budget and then the climax of the UK's Brexit negotiations presented issuers and investors with a veritable minefield of events to navigate from October into November, with inevitable casualties.

"The Brexit noise and Italy have certainly provided investors with a pretty decent cocktail of reasons not to be willing to buy into risk," said George Kalbin, director, FI syndicate, at Crédit Agricole CIB (CACIB).

As a result, few issuers ventured into the subordinated debt market across the two months. The risks of doing so were evident when BNP Paribas entered the market on 13 November despite US equities having fallen overnight and with temperatures again rising in the Italian budget saga.

The French bank went out with initial price thoughts of the mid-swaps plus 190bp area for a 12 year non-call seven Tier 2 trade, rated Baa2/BBB+/A-, and was only able to tighten pricing by 5bp to 185bp on the back of EUR675m of demand, with bankers away from the deal noting the ultimate EUR500m size was smaller than they would have expected from BNP Paribas. This was in spite of a new issue premium that one syndicate banker put as high as 25bp.

Other deals launched out of Europe in other sectors experienced similarly lacklustre demand, with bankers noting that some investors were already shutting up shop, unwilling to risk further negative performance in 2018.

"We were surprised that a few accounts are saying they are done for the year," said a syndicate official involved in one trade.

Kalbin at CACIB said he was surprised to see BNP Paribas hit the market.

"The market was only going one way," he said, "i.e. deteriorating, where nobody should have pulled the trigger. I'm sure they didn't expect things to go that way,

but as soon as they pushed out the trade they got punished."

BNP Paribas was at least able to execute a benchmark-sized subordinated trade; earlier in the autumn volatility two smaller issuers pulled debut Additional Tier 1 trades within days of each other.

Volksbank Wien opened books on a planned EUR150m perpetual non-call five AT1 on 4 October, with IPTs of the low 7% area, only to postpone its issue

> 'There were Tier 2 and AT1s planned that didn't come'

citing unstable market conditions. The Austrian bank said it would await the return of more stability to ensure successful execution for issuer and investors alike. The AT1 had an expected rating of Ba2 from Moody's.

The following Monday, 8 October, Van Lanschot went out with IPTs of the 6.5% area for an inaugural EUR75m-EUR100m perpetual non-call five AT1, with an expected rating of BB from S&P. The Dutch bank then also pulled its trade.

"To be honest, it was a little bit surprising to see them on screens after Volksbank Wien pulled just a couple of days beforehand," said a banker away from the deals. "I was sceptical about them proceeding in such an uncertain market.

"You have to bear in mind that both Volksbank Wien and Van Lanschot are, firstly, sub-benchmark AT1s," he added, "and secondly, they are non-listed banks, both of which limit the amount of investor interest you might see in these issues anyway."

The best laid plans

While the two unfortunate issuers may have suffered the most public travails in the sub debt market, others were reportedly close to pulling the trigger only to pull back at the last minute.

"There were Tier 2 and AT1s planned that didn't come to market," said CACIB's Kalbin. "Obviously issuers are regularly monitoring the market and may decide to issue or not, but the difference here was that the banks were mandated and the docs and term sheets were ready, but then the numbers went away from you.

"That has happened a lot since September and even more so since October. I'm sure the market conditions have clearly affected the overall funding expectations of some issuers, at least when it comes to doing a trade after Q3 results."

The unreliable markets proved most challenging — beyond smaller issuers — for peripheral credits.

"I'm sure a lot of people wanted to do a lot more in senior non-preferred, Tier 2, AT1, but it feels like you could only get away with a deal if you are a national champion — and I'm not even talking about Italy," said Kalbin, "or the very small issue sizes.

"And at the same time you have plenty of issuers who probably thought, OK, I would like to come to market, but I'll never get sign-off from the board at these levels."

The middle two weeks of November were cited as a particularly painful time for subordinated debt in the secondary market. Among peripheral credits, Intesa perpetual non-call fives, for example, widened some 100bp to 770bp over — their widest level of the year. Italian credits had nevertheless already been trading at heightened spreads given their specific backdrop, and some other peripherals widened even more over the same period, with Bankia perpetual non-call fives issued in September *(see below)* widening from around 575bp over to above 700bp, before recovering to trade inside that level.

At the other end of the spectrum, a Rabobank EUR1bn 4.625% perpetual non-call 7.25 issue, which had reopened the AT1 market on 4 September, widened some 40bp to trade at 390bp over.

And Tier 2 suffered in secondary as well as primary, with UK names unsurprisingly among those hardest hit. A EUR750m 10.5 non-call 5.5 Tier 2 sold by Lloyds at 130bp over mid-swaps in February was quoted at 360bp.

Indian summer proved fruitful

Lloyds had in early October been among issuers to find some respite from Europe's troubles in the US dollar market. On 2 October the UK bank printed a $1.5bn (£1.17bn, EUR1.32bn) perpetual non-call seven AT1 and the Baa3/BB- deal was priced at 7.5% following IPTs of the 7.75% area.

"That was a really good move considering the fact you've had them taking quite a beating in the market over the past two weeks as well," said a syndicate banker.

The trade came amid a raft of supply in US markets, and one syndicate banker suggested the dollar market was decoupling somewhat from the vagaries of European politics.

"I guess we don't need to worry if the European markets stay volatile for a little longer in the coming weeks," he said, "going through the Italian budget and Brexit saga, as well as the Bavarian election."

However, Lloyds' deal remained the last AT1 from a European issuer to be completed by late November, whether in euros or dollars, and potentially until year-end.

> 'You've had them taking quite a beating'

The volatility meanwhile meant that the euro market did not see a benchmark AT1 after 18 September, when BBVA issued in what might now be seen as halcyon days, where the most pressing issue facing markets was a potential global trade war.

The Spanish bank could price a EUR1bn perpetual non-call five AT1, rated Ba2/BB, at 5.875% on the back of a book that peaked at over EUR5bn and stood at some EUR3bn at re-offer, after pricing was tightened from IPTs of the 6.375% area and guidance of the 6% area. One banker put the new issue premium at 37.5bp.

BBVA's trade came a week after Bankia had on 10 September illustrated the positive post-summer conditions by issuing a EUR500m no-grow perpetual non-call five AT1 at 6.375% following IPTs of the high 6% area and guidance of 6.5%, plus or minus 12.5bp. The deal, rated BB- by S&P, had a EUR2.8bn book at re-offer after attracting some 220 orders.

And in the wake of BBVA's success, compatriot Abanca sold a sub-benchmark, EUR250m perpetual non-call five AT1 rated B by Fitch at 7%, following IPTs of the mid to high 7% area. At the time of writing, that transaction, on 24 September, looked like potentially the last AT1 in euros of 2018. ●

Photo credits: Theresa May: Number 10/Flickr; Giovanni Tria: European Council (Copyright EU)

2019: Primary outlook from CACIB's FI syndicate

To go or not to go? That is the increasingly fraught question issuers will be asking themselves in 2019 as macroeconomic and geopolitical uncertainty persists and volatility drives investors' strategies, according to Vincent Hoarau, head of FI syndicate at Crédit Agricole CIB.

Bank+Insurance Hybrid Capital: Would you expect 2019 to be a big year for bank debt issuance?

Vincent Hoarau, CACIB: Definitely. But many uncertainties remain around how that supply will shape up. In 2019 banks will continue to optimise their capital structures in accordance with MREL/TLAC requirements. Considering heavy redemptions across the board and new regulatory frameworks coming into place — mainly in the Nordic countries — we expect senior non-preferred/HoldCo gross issuance to reach around EUR155bn-EUR160bn in 2019. Meanwhile, a stronger focus will be put on liquidity and pure balance sheet funding. The funding mix has started to normalise, but is still driven by technicals such as MREL/TLAC, NSFR, and TLTRO refinancing. In June 2019, EUR400bn of TLTRO II funding will slip below one year until maturity. Banks will therefore have to anticipate this liquidity cliff and pre-fund their needs before the final repayments of the TLTRO II. The refinancing of the amount at stake seems an insurmountable task unless the ECB steps in. Having said that, the type of supply and issuance sequence will logically be influenced by the potentially new ECB operations that could be announced in the first half of the year. This is a major moving part of the equation.

Elsewhere, in the AT1 space, the list of calls to refinance is long and the sector may experience some volatility in that context.

BIHC: Will smaller banks be able to access the market for MREL/subordinated debt?

Hoarau, CACIB: Yes, but their strategies must be aligned with the new regime in the primary market. Idiosyncratic risks increased in 2018, with several issuers experiencing misfortune in primary and volatility around specific names. Investors are putting greater focus on national champions and on the most liquid transactions to better control their mark-to-market risk. This is a legitimate response to a very volatile and adverse environment where total returns have been execrable. In the second half of the year, many plans to sell subordinated debt have been postponed. Smaller issuers, namely those that are not established in the capital markets or with a smaller investor base, may struggle to sell deeply subordinated debt without a tailor-made marketing approach. Liquidity premiums will likely be added to new issues in 2019 for sub-benchmark Tier 2 or AT1. But it's not only about performance and volatility in a portfolio; investors realised that any type of debt can absorb losses, and subsequently sensitivity to names and balance sheet profiles will increase, together with the list of capital metrics scrutinised during the due diligence process. Non-deal roadshows and marketing throughout the year will be decisive for less frequent borrowers.

BIHC: How would you describe the way issuance conditions shaped up in 2018?

Hoarau, CACIB: Through 2018, technicals changed. We moved from a "fear of missing out" mentality driven by liquidity in January 2018 to a "buy on dips" mentality mid-year. We are now in the second phase of the transition period where people reassess the long term impact of the new liquidity regime on asset valuations in a market mainly driven by fundamentals.

BIHC: How would you describe the current situation?

Hoarau, CACIB: There is a new regime in primary and the stop-go mode is here to stay. Since Q2 2018, when central banks accelerated the tightening of unconventional measures, issuance volumes and windows have been strictly driven by fundamentals and no longer by liquidity. Meanwhile, the list of risk factors to navigate is getting ever longer. The Italian and Brexit sagas will contribute to fuelling volatility throughout Q1 2019. As the impact of fiscal stimulus fades in the US and trade tensions bite, concerns about the trajectory of economic growth in the US and China will drive global sentiment, causing wobbles in financial and credit markets. That said, headline risks to a large extent will continue to dictate market sentiment. How you generate attractive performance in such an environment is a question on every PM's mind — and consequently affects syndicates' recommendations to issuers.

BIHC: What is your greatest concern for the beginning of 2019?

Hoarau, CACIB: There is a clear and deep shift in market sentiment. As I mentioned, macro/geopolitical headline risks will remain elevated in an adverse interest rate environment for credit markets. But elsewhere, hedge fund liquidation persists, data has shown investor outflows continuing for a dozen straight weeks. And the net outflows are visible in IG as well as non-IG products.

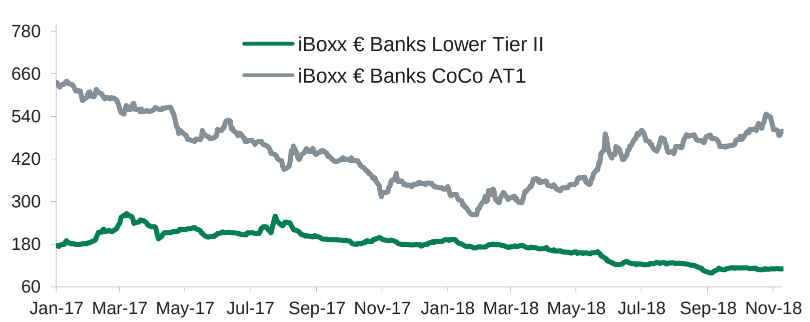
You may recall the extreme moves observed in May in short-dated BTPs. They fuelled a significant VaR shock across assets. Coupled with the ongoing volatility, these have a long term impact on the level of liquidity in the secondary market and on the genuine appetite of investors for risky credit assets. Bear in mind that you can't control your risk if there is no liquidity in the secondary market. So investors will either stay away from high beta instruments or request a higher liquidity premium! And this problem will be exacerbated for issuers approaching the primary market with sub-benchmark instruments — some already experienced such misfortune this year and had to postpone their offerings.

Adding to the growing list of concerns is a general move towards defensive portfolios that PMs may undertake as the list of US BBB- corporates on negative outlook grows by the day. This may impact valuations of high beta instruments issued by financial institutions across the board in 2019.

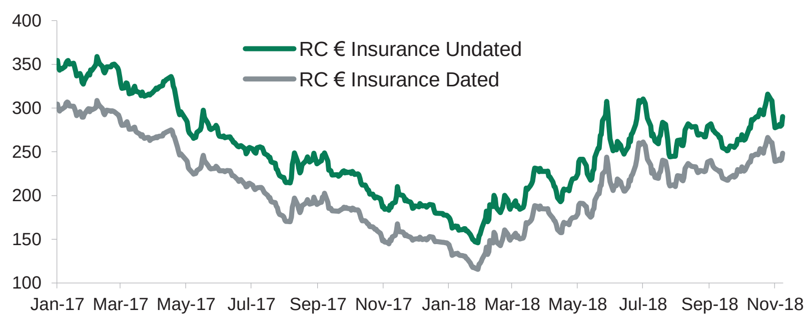
BIHC: Do you see any good news on the horizon?

Hoarau, CACIB: If the end of the US cycle is confirmed by a stronger than expected economic slowdown in Q1 2019, the Fed may be accommodative and revisit its rate hiking timeframe. The ECB could also review its interest rate rise commitment on the back of a bleaker outlook in Europe and be more explicit already in January on its intention vis-à-vis a TLTRO II “replacement”. This would give succour to the market. But for the time being, there's no open bar — central bankers have left the party and we should get prepared for a bumpy January. ●

Secondary bank subordinated indices (bp)



Secondary insurance subordinated index (bp)



Source: Markit, Crédit Agricole CIB

ING HoldCo, Commerz SNP hit green highs

ING sold the largest green bond from a European bank on 8 November, a EUR2.6bn equivalent inaugural green senior HoldCo transaction, after Commerzbank had on 16 October chosen the senior non-preferred format for its green bond debut, a EUR500m deal that attracted unusually high foreign demand.

ING's transaction was the first green issuance from the Dutch group since it debuted in the green bond market with EUR500m and $800m deals from ING Bank in 2015.

Under its updated framework, ING has earmarked some EUR4.5bn of loans as eligible for the proceeds of green bond issuance, with EUR2.9bn relating to renewable energy (wind and solar) and EUR1.6bn to green buildings. According to a pre-issuance impact report, an estimated 4.3 million tonnes of CO_2 equivalent of greenhouse gas emissions are avoided/reduced through the portfolio.

"It's clear that investors are increasingly looking to use their portfolios to help fight the growing threat of climate change," said ING head of sustainable finance Leonie Schreve. "We have to make an impact with our money and help investors be able to do the same."

Since its debut, the Dutch group has moved to a HoldCo resolution strategy, with senior issuance now primarily done out of the ING Group holding company entity to contribute to the group's TLAC and MREL buffers.

The new 144A/Reg S issuance for ING Group, rated Baa1/A-/A+, was split into EUR1.5bn 12 and $1.25bn (EUR1.1bn) long seven year tranches. The euro tranche is the biggest senior bank green bond in euros, while the US tranche is the biggest green bond issued by a European bank in any format, and the combined transaction is the largest green bond from a European bank.

The leads went out in the morning of 8 November, European time, with initial price thoughts of the mid-swaps plus 150bp area for the 12 year euro tranche and Treasuries plus 170bp for the long seven year dollar tranche, stating that each would be benchmark-sized. The new issue hit a

fixed income market that had reacted positively to US mid-term election results coming out as expected the previous morning.

After a little over an hour orders for the 12 year euro tranche topped EUR1bn, and after around an hour and a quarter the size was set at EUR1.5bn on the back of EUR3.3bn of demand, pre-reconciliation, and guidance at 135bp-140bp, will price in range. Half an hour later books were closed at EUR4bn, pre-reconciliation, and the pricing set at mid-swaps plus 135bp.

'The green bond element helped scope out demand'

Pricing on the long seven year dollar tranche was tightened from the IPTs of 170bp over to the 155bp area, plus or minus 5bp, and the $1.25bn deal was then priced at 150bp Treasuries. The book reached as much as $3.2bn, and $2.75bn was good at re-offer.

Fadi Attia, managing director, US dollar FIG at joint bookrunner Crédit Agricole CIB in New York, put the new issue premium at a relatively low 7bp, with fair value seen at around 143bp over based on an interpolation of the issuer's outstanding five and 10 year paper, as well as comparables such as French names in senior non-preferred format.

"Given the market volatility throughout the month of October, recent trades have only been moving between 10bp and 15bp from IPTs to pricing, so the fact that we've been able to move 20bp and maintain more than two and a half times oversubscription underscores the success of this trade," he said, "particularly given that it comes on the back of over EUR6bn of HoldCo issuance from them across dollars and euros just a month ago.

"That is testament to the fact that US investors are very comfortable with ING as a credit and their exposure at the HoldCo level from a bail-in perspective. The green bond element helped scope out demand even further, taking advantage of a growing pool of green money in US dollars — some of which is dedicated portfolios."

Attia noted that there has been little green bond supply in dollars relative to the European market.

"This whole effort, in terms of establishing liquid benchmarks in dollars as well as euros, is very welcome, especially in the FI bail-in space," he said. US accounts were allocated 71% of ING's dollar tranche, Asia 18%, and Europe 11%.

ISS-oekom provided a positive second party opinion on the green bond, also confirming its alignment with the Green Bond Principles, and ING obtained pre-issuance certification from the Climate Bonds Initiative.

Commerzbank finds broad home

Commerzbank's debut green bond on 16 October, a EUR500m five year senior non-preferred benchmark with proceeds earmarked for renewable energy financing, attracted some EUR1.25bn of demand from over 100 investors to the debut, with 87% placed outside Germany.

The German bank's framework initially encompasses solar and onshore and offshore wind energy projects in Germany and abroad, with the EUR503m of assigned assets avoiding an estimated 755k tonnes of CO_2 per year.

"Commerzbank is as an institution very much committed to sustainability," said Franz-Josef Kaufmann, deputy head of capital management and funding and head of strategic markets and projects at Commerzbank. "The bank has a significant portfolio of assets in our centre of competence energy, where we finance renewable assets, and in that portfolio we have a meaningful amount of loans that we felt would make a strong underlying for a first green bond."

The framework has a second party opinion from Sustainalytics, which noted that it is "robust, credible and transparent", and also aligned with the Green Bond Principles. The new issue was preceded by a roadshow focusing on green bond investors.

"In addition to our framework and the structure of the green bond, we have also had very interesting discussions with investors about Commerzbank's sustainability strategy and how the green bond programme fits into this," said Mirko Gerhold, head of DCM bonds solutions at Commerzbank, which structured its own programme and was joint bookrunner.

Commerzbank chose to issue its inaugural green bond in senior non-preferred format.

"When we consider issuing a green bond, it needs to fit into the overall funding requirement of the bank," said Kaufmann. "The overwhelming success of our inaugural preferred senior bond meant that it shipped in more funding than originally expected, and with that


Franz-Josef Kaufmann, Commerzbank

we covered the majority of our preferred funding needs."

"We still required a bit of non-preferred funding, and that's why we decided to use the non-preferred instrument as the format for this green bond."

Fixed income markets had been volatile in the two weeks leading up to the new issue.

"Obviously we had been following the market when we were on the road, and we saw that there had been a significant amount of volatility," said Kaufmann. "The interesting aspect was that beside all the noise we had seen, credit spreads — in particular credit spreads around our name — had been fairly stable. And that gave us a bit of comfort that structurally the market should for credit be in decent shape.

"We decided not to jump immediately on Monday into a market still digesting the volatility of the week before, but thought that the second day, i.e. Tuesday, could be a good day, and looking back I think it was the right choice. Capital markets and equity markets recovered, we saw numerous transactions announced throughout the day, and we got a very strong reception for our bond."

The lead managers went out with initial price thoughts (IPTs) of the 105bp-110bp over mid-swaps for the EUR500m no-grow five year senior non-preferred benchmark. Fair value was put at around 80bp over mid-swaps, with Commerzbank's outstanding September 2023s bid at 78bp over mid-swaps and May 2024s at 93bp over.

"To generate momentum we went out with the 105bp-110bp IPTs, having in mind to break through the 100bp level, and even 95bp," said a syndicate banker at one of the leads. "Looking at the book and dynamics, we could have achieved the latter, but the issuer decided to be fair and grant the 15bp NIP in recognition of the success of the roadshow and investors' engagement."

The deal was priced at 95bp over mid-swaps on the back of over EUR1.1bn of demand from more than 100 accounts, with demand having peaked around EUR1.25bn before the final pricing was set. Some 87% of the paper was placed outside Germany, which bankers noted was particularly high for a German bank issue.

"When arranging the roadshow, we very much targeted seeing green investors," said Kaufmann, "and that's how we chose the regions and investor meetings. Looking into the allocations, some 60% was to investors in so-called green centres, such as the Benelux, France and Scandinavia. It is hard to identify exactly which investors are green, but I would say that we had above EUR500m of greenish investors in the book — either green investors or other investors with green portfolios.

"Looking at the success of the trade," he added, "I think we have chosen the right strategy and created a robust structure that has been accepted by the green investor community, which very much stresses green frameworks to get an idea how robust they are."

Those involved in the trade said it was unclear if the green nature of the bond had influenced pricing, but said it had definitely helped the strong outcome.

"Investors are still craving green supply from banks, which has remained relatively subdued this year, while pressure for green bond investments and subsequent demand keeps on increasing," said André Bonnal on the FIG syndicate desk at joint bookrunner Crédit Agricole CIB. ●

Photo credit opposite: ING/Flickr

Rare Munich Re shows strengths amid fall volatility

Munich Re demonstrated its appeal to investors with a twice-subscribed EUR1.25bn Tier 2 trade on 15 November amid market conditions that led to a UK covered bond being pulled, as insurers experienced mixed outcomes in the bouts of volatility that characterised the autumn market.

Ahead of its first subordinated bond in six years, the German insurer announced its plans for a 30.5 non-call 10.5 Reg S Tier 2 trade and roadshowed its benchmark, rated A2/A by Moody's and Fitch, on the Monday and Tuesday of the week of launch.

It then entered the market on the Thursday morning, the day after the UK cabinet had approved a draft Brexit withdrawal agreement with the EU. Although the market opened relatively stable, a renewed bout of volatility was sparked by UK ministerial resignations, leading TSB to pull a five year sterling FRN after opening books.

Munich Re was nevertheless able to press on with its trade after the leads had opened books with initial price thoughts of the 250bp over mid-swaps area and were soon able to announce a book update above EUR1.25bn. They then set pricing at 240bp over on the back of a book of some EUR2.5bn.

A syndicate banker away from the leads estimated the deal paid a new issue premium of around 25bp, based on fair value of 215bp, taking into account Munich Re's old outstandings but also comparables from more regular peer Allianz.

"Munich Re has tremendous scarcity value and is strongly rated even for Tier 2," he said, "so it's almost a safe haven investment for investors even if it's subordinated. That is demonstrated by the strong support for the trade in a market where people are very selective — investors know it may be another five years before they can get their hands on this credit again.

"It's also proof that there is cash to put to work."

The challenging market conditions had earlier deterred Aegon from launching its inaugural Restricted Tier 1 transaction. The Dutch insurer had on 9 October announced plans for a perpetual non-call 10.5 euro benchmark RT1 and mandated banks for investor meetings from 11 October.

However, Aegon's issuance plans were put on hold the following week as market conditions deteriorated. The insurer is expected to revive its plans at a more opportune time.

'It's also proof that there is cash to put to work'

There has been better news for holders of compatriot Vivat's bonds, with the developing news of troubled Chinese parent Anbang's plans to sell the company. Aegon as well as ASR have been seen as potential buyers.

"Part of the pushback from investors on Vivat's issuance was that the ownership was a bit sketchy," said one syndicate banker, "and now everyone wants to know who's going to make an offer for it. If you take a look at its perp non-call 2025 RT1 now, it's a clear outperformer and still trades well above par despite the recent general spread widening."

Groupama outshines Phoenix

Munich Re's deal was the first insurance Tier 2 supply in euros since September, when Groupama and then Phoenix Group approached the market in quick succession.

Groupama's EUR500m no-grow 10 year bullet on 17 September put the seal on its recovery, following the return of its sub debt to investment grade in May 2017 on the back of an upgrade of the insurer from BBB+ to A- by Fitch, which also put the higher rating on positive outlook this April. The new issue was the French insurer's first transaction since then and also its first wholly new money transaction since 2009.

"Fitch Ratings' decisions paved the way for the successful debt issuance we conducted in September," Cyril Roux, CFO of Groupama group, told *Bank+Insurance Hybrid Capital (see Q&A on page 13 for more from Groupama).*

Groupama opted for a 10 year bullet structure to achieve full equity credit with Fitch as well as Tier 2 Solvency II treatment, and also offer investors a plain vanilla instrument.

With the market outlook encouraging but uncertain, the insurer and its leads opted for intra-day execution on Monday, 17 September. Books were opened with initial price thoughts of the mid-swaps plus 270bp area for the EUR500m no-grow transaction, and after around two hours orders reached EUR1bn. Another hour and a half later guidance was set at the 255bp area on the back of a

EUR1.25bn book. Twenty minutes later, with books above EUR1.35bn comprising more than 110 accounts, the spread was fixed at 250bp over, which the leads said represented a new issue premium of around 10bp.

"All in all, it went very well and we are very satisfied with the outcome," said Groupama's Roux.

André Bonnal on the FI syndicate desk at joint bookrunner Crédit Agricole's said investors were clearly happy to buy into Groupama's recovery story, buoyed by the January 2027 issue's performance — it was trading at a cash price of 121 when the new issue was launched — with the 10 year bullet structure also key.

"We were able to tighten by 20bp to finish at 250bp, with a book in the context of EUR1.35bn for a EUR500m deal, with very few drops, which is a very strong sign for the issuer going forward," he said, "so all in all a top notch transaction that ticked all the boxes."

Phoenix Group Holdings' similar EUR500m (£445m) 10 year Tier 2 issued two days later (19 September) encountered a more subdued reception, generating little oversubscription and pricing in the middle of guidance.

The UK issuer had held investor meetings across Europe ahead of the planned trade, rated BBB by Fitch, and went out with initial price thoughts of the 350bp over mid-swaps area. The deal was then priced at 350bp over on the back of some EUR600m of demand.

The transaction was launched in conjunction with Phoenix's acquisition of Standard Life Assurance, announced in February and completed at the end of August, for close to £3bn. Prior to the euro benchmark, the issuer only had subordinated debt outstanding in sterling and US dollars.

"I think they were looking to increase the investor base here," said a banker away from the deal, "but it's a closed-book business and there's no such thing in continental Europe, and it appears European investors found the credit story difficult to get their heads around."

Mapfre rides out emerging spike

Mapfre had earlier reopened the subordinated insurance market on 31 August and the wider sub debt market for southern European financials with a EUR500m 30 non-call 10 Tier 2 trade.

The Spanish insurer was approaching the market in conjunction with taking full control of Mapfre BB SH2, the Brazilian company through which it runs a strategic alliance with Banco do Brasil, for around EUR546m. Announcing the updated cooperation with Banco do Brasil in June, Mapfre said hybrid debt issuance would help fund the transaction and mitigate its impact on the insurer's solvency capital.

> 'It was a really good sign we got hardly any drops'

Mapfre approached the market on 30 August despite ongoing noise around emerging markets in Latin America and elsewhere, with Bonnal at joint lead CACIB noting that conditions had stabilised in the preceding sessions. The issuer did not hold a roadshow, but opted for one-and-a-half day execution to give time to prepare for the new issue, including calls with investors.

A 15% interest rate hike in Argentina then sparked a renewed sell-off in emerging market assets overnight, but Mapfre went ahead with its new issue on the back of encouraging feedback from investors, according to Bonnal. However, with its outstanding 2047 non-call 2027 issue having fallen some two points since the new issue's announcement, pricing and IPTs had to be considered carefully, he added.

The leads went out with initial price thoughts of the mid-swaps plus 340bp area for a benchmark-sized 30 non-call 10 issue, rated BBB- by Fitch, and after around an hour and a half orders had surpassed EUR500m. After three hours guidance was revised to the 330bp area and the size set at EUR500m on the back of over EUR750m of demand, and books went subject after around three and a half hours, with the pricing fixed at 330bp shortly after with orders above EUR700m, pre-reconciliation.

"It was a really good sign that we got hardly any drops when we tightened 10bp," said Bonnal, noting the move was larger than on some recent subordinated trades.

"This issuance further proves the confidence institutional investors have in Mapfre," said Fernando Mata, Mapfre CFO. "We have achieved very satisfactory financial conditions even in the current complex market environment." ●

Photo credits: Munich Re (opposite); Ricardo Ricote Rodriguez/Flickr

Investors show faith in Prudential's M&G 'flipper'

Prudential plc laid the foundations for the planned spin-off of its UK and continental European business on 26 September with the sale of £1.63bn equivalent of sub debt that contains a "flipper" clause allowing the issuer to be substituted with the UK holding company of the new M&G Prudential.

The insurance group had announced the demerger plans in March and on 17 September said it was updating its MTN programme prospectus to reflect that the shareholder Solvency II ratio of M&G Prudential will be around 170%, with the new company holding around £3.5bn of subordinated debt.

It said that prior to the demerger it would be rebalancing its debt capital across Prudential and the new M&G Prudential HoldCo, and then announced the three-tranche transaction with the flipper clause.

The following week, on 26 September, the issuer priced the £1.63bn equivalent (EUR1.82bn, US$2.14bn) Tier 2 deal, rated A3/BBB/BBB, split into three tranches: a £750m 33 year non-call 13, a £500m 50 non-call 30, and a US$500m (£380m) 30 non-call 10.

Following initial price thoughts of Gilts plus 410bp-420bp for the £750m 33NC13, guidance was set at the 405bp area, and the re-offer at 400bp, while the £500m 50NC30 went from IPTs of Gilts plus 440bp-450bp, to guidance of the 435bp area, and a re-offer of 430bp. Demand for the sterling tranches was a combined £2.9bn, skewed towards the shorter tranche, which could thus be sized larger and tightened more than the longer tranche, and went on to perform better in the secondary market.

'It's still a bit of a black box for investors'

The $500m 30NC10 tranche was priced at 6.5% after IPTs of the 7% area, with demand totalling some $4bn.

A syndicate banker away from the leads suggested that the IPTs reflected the lack of clarity for potential investors on the future shape and risk profile of M&G Prudential.

"Prudential is a very well respected company and investors will expect M&G Prudential to be well run, but it's still a bit of a black box for investors," he said. "The issuer will have been cognisant of that and the IPTs, particularly on the US dollar tranche, offered a very nice premium to offset that."

He noted that the 7% area for the 30NC10 was more than 100bp wide of where L&G was trading in the secondary market, while BNP Paribas had issued a lower rated dollar AT1 at 7% in August.

"In the end they were able to tighten by 50bp and print at 6.5%, with books around $4bn," said the syndicate banker. "At 6.5%, it's around 25bp back of where L&G would have printed a similar new issue, which is not a big premium when you think this is a bond destined to be for a company that is not yet fully formed.

"It was an innovative and pragmatic way for Prudential to precapitalise now rather than waiting and not knowing how market conditions will be in future," he added. "And from an investor's point of view, you can get exposure to a nice story now, with an additional premium." ●

League tables

Bookrunners all European FI hybrids (euros and US dollars) 1/1/2018 to 12/11/2018

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	HSBC	23	7,776	13.3
2	Credit Suisse	17	4,602	7.9
3	Barclays	15	4,525	7.7
4	BNP Paribas	20	4,297	7.3
5	UBS	13	3,391	5.8
6	Crédit Agricole CIB	11	2,890	4.9
7	JP Morgan	23	2,885	4.9
8	Morgan Stanley	15	2,663	4.6
9	Citi	17	2,603	4.5
10	Société Générale CIB	11	2,503	4.3
11	Goldman Sachs	11	1,993	3.4
12	BofA Merrill Lynch	11	1,863	3.2
13	Lloyds	5	1,465	2.5
14	Deutsche Bank	12	1,429	2.4
15	NatWest	8	1,182	2.0
	Total	144	58,552	

Source: Dealogic, Thomson One Banker, Crédit Agricole CIB

Bookrunners all financials (euros) 1/1/2018 to 12/11/2018

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	BNP Paribas	65	15,504	9.0
2	UBS	36	14,291	8.3
3	HSBC	54	12,110	7.1
4	Société Générale CIB	37	11,895	6.9
5	Deutsche Bank	47	10,518	6.1
6	Natixis	30	9,268	5.4
7	Crédit Agricole CIB	32	8,532	5.0
8	JP Morgan	44	7,834	4.6
9	Citi	34	6,319	3.7
10	Morgan Stanley	29	6,127	3.6
11	Barclays	33	6,046	3.5
12	Goldman Sachs	27	5,915	3.5
13	NatWest	25	5,047	2.9
14	BofA Merrill Lynch	26	4,299	2.5
15	Credit Suisse	23	3,979	2.3
	Total	279	171,441	

Includes banks, insurance companies and finance companies. Excludes equity-related, covered bonds, publicly-owned institutions.

Groupama EUR500m sub comeback seals recovery

Groupama put the seal on its recovery on 17 September with its first wholly new money transaction since 2009 and its first since its sub debt was returned to investment grade by Fitch last year, in a EUR500m no-grow 10 year deal that attracted over EUR1.35bn of demand from more than 110 accounts. Groupama group CFO Cyril Roux *(pictured)* discussed the significance of the trade with *Bank+Insurance Hybrid Capital*.

Why did you approach the market with such a transaction at this time?

Cyril Roux, Groupama: The purpose of this new issue was to manage Groupama's capital structure, extend our maturity profile and improve our financial flexibility in a cost-efficient manner, taking into account our redemption profile.

As regards the timing, we anticipated, in line with our banking syndicate, more supply in the subordinated space after the summer and higher market volatility in the coming months.

Hence, we got everything ready to be able to launch the transaction as soon as we published our half-year results. We took advantage of a good earnings momentum and supportive market conditions.

What developments have there been since you last issued a subordinated transaction, in January 2017?

Cyril Roux, Groupama: Groupama has completed its financial recovery, which started a few years ago. The bottom line and profit margins have grown while our solvency ratio has returned to a very comfortable level broadly in line with our peers.

This recovery is reflected in our recent ratings history. In May 2017, Fitch Ratings upgraded our Insurer Financial Strength (IFS) rating from BBB+ to A-. Our subordinated debts thus became classified as investment grade instruments. Then in April 2018, Fitch revised the outlook associated with Groupama's rating to Positive from Stable. Fitch's decisions paved the way for the successful debt issuance we conducted this September.

Why did you choose the structure you used?

Cyril Roux, Groupama: In May 2014 and in January 2017, Groupama came to the market with two liability management transactions involving an exchange offer and some potential new money issuance.

> **'The bottom line and profit margins have grown'**

Now that we are recognized as a bona fide investment grade issuer, there was no need for a liability management exercise. The transaction we conducted this September represented the first new money transaction from the group since 2009. We wanted it to be the most investor-friendly instrument, ergo, a plain vanilla 10 year bullet Tier 2 instrument. As the icing on the cake, this structure is also an inexpensive form of Tier 2 capital under Solvency II.

Insurance companies usually issue 30 non-call 10 or perp non-call 10 types of structure to comply with S&P or Moody's equity credit requirements. Since Groupama is rated by Fitch, we could issue a 10 year bullet; Fitch's methodology gives full equity credit for this type of instrument within their Prism model.

How satisfied were you with the demand and pricing that you achieved?

Cyril Roux, Groupama: All in all, it went very well and we are very satisfied with the outcome. We closed the deal with a final spread of mid-swaps plus 250bp and an order book more than three times oversubscribed. In addition to high demand, the book was of exceptional quality. There was little concession and there hasn't been subsequent tightening, which goes to show the keenness of the pricing achieved by our banking syndicate.

The success of the transaction fully validated our choices of a vanilla transaction and of a one day execution without a physical roadshow.

How do you feel about how you are now positioned in the market?

Cyril Roux, Groupama: The success of the transaction establishes Groupama as a dependable European investment grade financial institution and testifies to the strength of our position with investors. ●

Regulatory updates

EBA stress tests

On 2 November, the European Banking Authority (EBA) published the results of the much-anticipated stress tests for 48 banks across Europe. The results reflect that the European banking sector is resilient and able to withstand severe shocks.

- 2018 vs. 2016 stress test: The average CET1 drawdown in the Adverse Scenario was 395bp vs. 340bp in 2016
  - Relative winners: compared with the 2016 tests, AIB, ABN Amro, Commerzbank and LBBW performed much better this time around relative to the sector and themselves
  - Relatively weaker: Lloyds, Danske, Helaba, Barclays, Deutsche, NordLB, BayernLB, Jyske and Crédit Mutuel Group performed relatively worse this time around relative to the sector and themselves
- UK, German and Irish banks are the most impacted under the Adverse Scenario in terms of headline impact under this test
  - Results for the UK banks have less practical implications given their requirements will be set via the Bank of England stress tests that will be published on 5 December
  - Irish banks (Bank of Ireland, AIB) were not subject to MDA restrictions or trigger breaches during the Adverse Scenario in any year
- Spanish banks (Santander, BBVA, CaixaBank) were amongst the best performers in the stress tests, behind only Norway (DNB) and Poland (PKO, Pekao)
  - However, Santander, CaixaBank and Sabadell were subject to MDA breaches during two years in the Adverse Scenario, and BBVA for one year
  - Intesa and KBC also performed strongly
- Seven banks were subject to MDA breaches for all three years under the Adverse Scenario, 12 banks for two years, and six banks for one year
  - Three years: Barclays, Commerzbank, BNP Paribas, Deutsche, Société Générale, NordLB, Banco BPM
  - Two years: Lloyds, Rabobank, ING, Helaba, RBI, UniCredit, Santander, HSBC, CaixaBank, DZ, Erste, Sabadell
  - One year: LBBW, La Banque Postale, Nordea, BPCE, RBS, BBVA

Methodology overview:

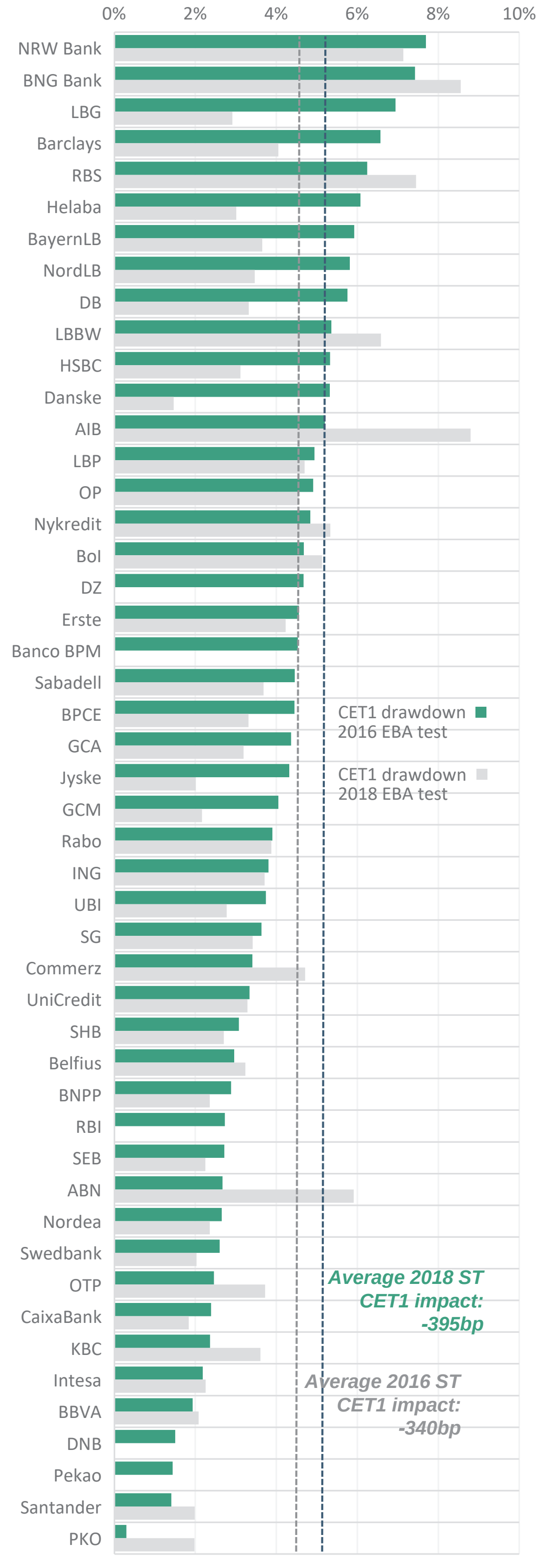
- 48 banks were included in this year's exercise
  - 33 banks were from the SSM region
  - No pass/fail threshold, the outcomes will be the starting point of the Pillar 2G setting exercise within SREP for 2019 (refined for balance sheet development since the stress test cut-off date, credible management actions and supervisory judgement (NB: P2G expected to be a positive number under all scenarios))
  - Cumulative fall in GDP of 2.7% over three years, unemployment to reach 9.7%, cumulative inflation of 1.7%, residential property to fall by 19.1%, commercial property to fall by 20%

Photo: EBA

  - The Adverse Scenario this year was more severe than the corresponding scenario in 2016
  - Relative to the US Comprehensive Capital Analysis and Review (CCAR) tests, the EBA stress scenario falls in between the Adverse and the Severely Adverse scenarios (as per EBA and European Central Bank own disclosures)
- IFRS 9 has been taken into account in this exercise
  - The starting point of the exercise was a restatement of the CET1 ratios to include the first time application of the new accounting standard
  - 16 banks out of the 48 covered in the stress test apply transitional provisions for IFRS 9, out of which one is applying only a static approach and the remaining 15 apply both static and dynamic approaches
  - Static component of IFRS 9 transitional arrangements — comparison of provisions under IAS 39 and IFRS 9 upon first time application and net impact on CET1 ratio phased in on both numerator and denominator over the transitional period -> does not impact Stress Test outcome
  - Dynamic approach of IFRS 9 transitional arrangements — banks compare the Stage 1 and 2 provisions at the beginning and end of each year and are then allowed to phase a net impact on the CET1 ratio
  - The application of the dynamic component of IFRS 9 is the main reason behind the difference between the transitional and fully-loaded CET1 ratios in the 2020 Adverse Scenario (overall 10.3% transitional CET1 vs. 10.1% fully-loaded CET1)
- Adverse Scenario includes a wide range of macroeconomic risks associated with Brexit
- Banks were subject to the following broad stresses according to risk category:
  - Credit risk, including securitisation
  - Market risk, counterparty credit risk, CVA
  - Operational risk, including conduct risk

Other updates

Fully-loaded CET1 drawdown: 2018 vs. 2016 EBA stress tests, Adverse Scenario



Source: EBA, Crédit Agricole CIB

Finland approves law introducing SNP debt

On 19 October, Finland's parliament passed legislation introducing the senior non-preferred debt class

Dutch government publishes 2019 tax plan abolishing corporate income tax interest deduction for AT1/RT1 instruments issued by banks and insurers

- On 18 September, the Dutch government published the tax plan for 2019, including the abolishment of tax interest deduction for AT1/RT1 as of 1 January 2019
- Coupon payments under new and existing AT1/RT1 instruments will no longer benefit from a specific deduction provision under Dutch corporate income tax laws
- The decision to abolish the deduction was made partly in order to avoid legal state aid proceedings as such concerns were previously raised by the European Commission.
- The Dutch government also suggested abolishing the Dutch dividend withholding tax as of 1 January 2020, although it would be replaced by a conditional withholding tax if certain payments are made to group or related entities in low tax or non-cooperative jurisdictions
- No impact is expected in other countries at this stage

Norwegian FSA presents various proposals, including:
(i) MREL legislation
(ii) Removal of the Basel I floor
(iii) Revision of the O-SII framework

- On 29 June, the Norwegian FSA (Finanstilsynet) published a proposal that included the introduction of MREL in Norway
- MREL is expected to come into force on 1 January 2019
  - MREL requirement will be set initially for the largest institutions, with a full subordination requirement expected for such entities
  - Banks are expected to have to comply with the subordination requirement from 31 December 2022
- The Norwegian FSA also proposes removing the Basel I floor (expected to increase capital ratios), but at the same time the capital requirements for banks are expected to increase via increases in Pillar 2 and/or wider scope of O-SII (note that the Norwegian FSA approach for designating O-SIIs is different from the EBA methodology)

Denmark increases countercyclical capital buffer (CCyB) from 0.5% to 1.0%, effective from 30 September 2019

Ireland increases CCyB from 0% to 1%, effective from 5 July 2019

Sweden increases CCyB from 2.0% to 2.5%, effective from 19 September 2019

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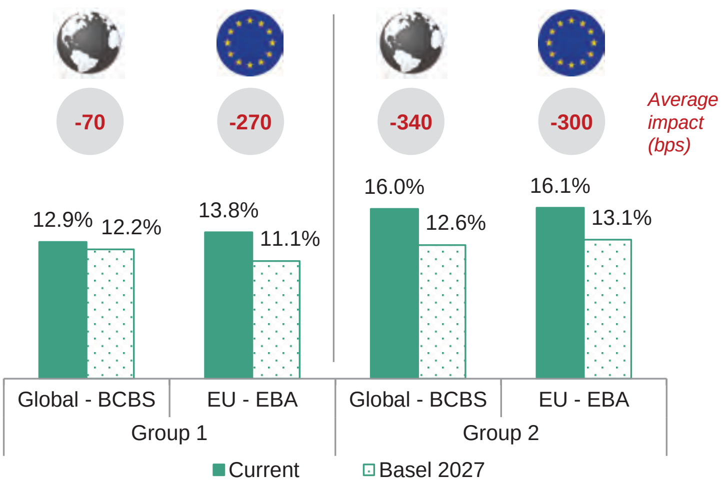
Focus on Basel III reforms

Basel III monitoring: BCBS & EBA impact analyses

- The Basel Committee on Banking Supervision and the EBA both published impact analyses of the application of the Basel III reforms, with 31 December 2017 data on banks
- The Basel Committee sample includes banks across all jurisdictions, whilst the EBA includes EU banks only
- According to the respective results, the EU Group 1 banks are worse off than their global counterparts (-270bp CET1 impact vs. -70bp), whereas the impact for Group 2 banks are comparable (EU banks better off)
- Group 1 banks are defined as those that have more than EUR3bn Tier 1 capital and are internationally active. Group 2 includes the rest

Impact of Basel III final package on CET1 ratios

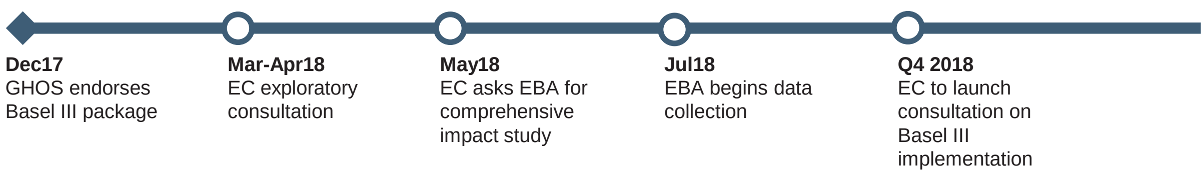


Source: Crédit Agricole CIB

Basel III application in the EU

- The legislative package for the application of the final Basel III reforms in the EU is expected to be published initially in H1 2020
- The European Commission has issued a Call for Advice to the EBA to conduct a comprehensive impact analysis (quantitative and qualitative) on the application of the Basel III package on EU banks, with expected publication in June 2019
- The Commission is also expected to launch a consultation on Basel III implementation in the EU toward the end of 2018
- The outcomes of the EBA impact analysis and the Commission consultation will form the basis of the final package on how Basel III reforms are implemented in the EU
- Several EU stakeholders have publicly stated the intention to adhere to the internationally agreed package as closely as possible

Possible timeline for Basel III implementation in the EU



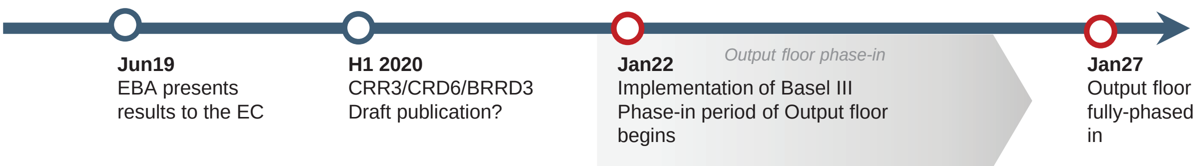
Focus on RRM

Progress of the Risk Reduction Measures package trilogue

- The trilogue process between the Council of the EU (Council), the European Parliament (EP) and the European Commission (EC) on the Risk Reduction Measures (RRM) package has been ongoing since the summer, and there is a strong push to finalise the negotiations by the end of the year:
  - The Austrian Presidency of the Council will expire on 31 December 31, and the change could lead to a loss of momentum
  - The Parliament may also have a very different composition following elections in May 2019
  - Certain elements of the RRM package are supposed to apply (retroactively) from 1 January 2019 (e.g. TLAC)
  - The transposition of the final Basel III reforms into EU legislation will be part of the next legislative cycle, therefore the current package would ideally be finalised prior to that
  - The Council view is that all elements of the RRM package have to be agreed and there will be no separation of legislative pieces as per the Parliament proposal
  - There are four further trilogues scheduled to take place from 13 November to 5 December
- In broad terms, the state of play as per CACIB's understanding is outlined in the table below.

Agreed in principle	Discussed but not agreed	Key elements not yet discussed
Grandfathering of Own Funds and MREL instruments o 6 years	MREL subordination requirements	Fundamental Review of the Trading Book (FRTB)
Leverage surcharge for SIFIs o 50% of RWA buffer	**Proportionality** o Criteria for identifying small and large banks o Council defines Top Tier banks as > EUR100bn assets, with flexibility to include others	**Net Stable Funding Ratio (NSFR)**
Leverage MDA (L-MDA) o Initially relevant for G-SII only	**Pillar 2G setting** o EP proposed a P2G floor equivalent to losses faced in stress tests relative to a pre-defined floor of P1+P2R	
CET1 buffers additivity o O-SII and SRB will be additive up to a 5% cap	**Reporting and disclosure on MREL**	
Newly issued capital instruments o EBA to be in charge of review and approval process	**Home-Host balance** (pre-positioning, internal MREL, etc)	
Redemption of capital instruments o EC mandated to propose a com promise text	G-SII score within the Banking Union	
SME supporting factor in specific cases	**Sustainable finance** o ESG risks in the SREP	
	Large Exposures o Shadow banking, aggregate limits and exemptions	
	Moratorium	

Source: Crédit Agricole CIB



Source: Crédit Agricole CIB

Focus on UK & Brexit

UK insurance RT1 instruments: PRA consultation paper on the tax adjustment of RT1 write-down instrument

- Following tax changes introduced by Her Majesty's Revenue & Customs (HMRC) in the UK Budget on 29 October, the PRA has published a Consultation Paper, CP27/18, which discusses the implications for Restricted Tier 1 (RT1) instruments
- The PRA proposes that insurers deduct the maximum tax charge generated on write-down (i.e. a reduction in the eligible amount) when including RT1 capital instruments with a write-down structure in their own funds
- Equity conversion RT1 are not affected by the CP because those instruments will not be taxed upon conversion
- The consultation will close on 2 January 2019. The PRA indicates that the new approach will be applied for all new issuances after 31 January 2019
- Regarding potentially affected outstanding RT1 instruments (e.g. Phoenix, Rothesay), the PRA will discuss appropriate arrangements on a case by case basis
- For now, it seems that bank AT1 instruments are not affected. This may be explained by Conditions E in section 322 of the Corporation Tax Act, which grants an exception to this taxation rule. This Condition E is likely to be met "if the write-down occurs only at a level where, without a write-down, there would be a material risk of a collapse of confidence in the institution within 12 months". The PRA has assessed that RT1 do not meet this condition because the trigger level is not set at a level where it is not likely that there would be a material risk of a collapse of confidence in the institution within 12 months. The interpretation may be different for bank AT1 but this remains to be confirmed

Her Majesty's Treasury (HMT) consults on transposition of EU Bank Creditor Hierarchy Directive (CHD) in the UK

On 12 September, the UK invited responses on its proposal for implementing the CHD in the UK and introducing a new class of senior non-preferred debt

Bank of England publishes approach to EU withdrawal

On 25 October, the Bank of England (BoE) published a package of communications including information on its approach to the UK's withdrawal from the EU, which relates to arrangements for the BoE's temporary permission regime (TPR) and financial services legislation. A high-level summary of its approach was presented in a Dear CEO letter addressed to all firms authorised and regulated by the Prudential Regulation Authority (PRA) as well as EEA firms undertaking cross-border activities into the UK from elsewhere in the EU via passporting.

PRA consults on applying systemic risk buffer framework

- On 3 July, the PRA commenced a consultation on proposals to amend the UK leverage ratio to reflect the systemic risk buffer (SRB) framework
- The SRB framework, which is expected to be implemented in 2019, subjects D-SIBs to a leverage ratio buffer:
  - Application of the UK leverage ratio framework on a sub-consolidated basis to ring-fenced bodies (RFBs) whose groups are already required to meet leverage ratio requirements on a consolidated basis
  - Amending the additional leverage ratio buffer to reflect the SRB
  - Where applicable, expecting firms to hold capital on a group consolidated basis to address RFB group risk (the Leverage Ratio Group Add-on)

Other updates

APRA releases discussion paper on loss-absorbing capacity for ADIs

On 8 November, APRA proposed a loss-absorbing framework for Australia's four major banks, increasing total capital requirements by 4%-5% in terms of Risk-Weighted Assets (RWAs). For the other Authorised Deposit-taking Institutions (ADIs), there is likely to be no adjustment, although a small number may be required to maintain additional total capital depending on the outcome of resolution planning. The key takeaways are:

- The new framework will likely only apply to D-SIBs (the four major banks)
- APRA expects that banks will effectively hold total capital in the range of 18.5%-19.5%
- No new form of capital is being discussed, with APRA expecting that the majority of additional capital required be met with Tier 2 capital
- The new rules are planned to be fully implemented by 2023 (four years)

Photo: UK Chancellor Philip Hammond; Credit: European Council; Copyright EU

EBA Q&A
Triggers, calls & UK law

Do AT1 trigger levels still make sense? What factors determine whether banks can call AT1s? And how could Brexit affect UK law issuance? Delphine Reymondon, head of the liquidity, leverage, loss absorbency and capital unit, European Banking Authority (EBA), shared her thoughts on these current questions with *Bank+Insurance Hybrid Capital* and Crédit Agricole CIB.

Bank+Insurance Hybrid Capital: The absolute level of triggers on AT1, particularly the 5.125%, appear a bit low compared with reality, with the risk that they are increasingly perceived as gone concern rather than going concern instruments. Are supervisors contemplating any changes? And does this mean there is a greater need to give more clarification on the point of non-viability (PONV)?

Delphine Reymondon, EBA: First, we should probably recall how we originally fixed these levels, in particular the 5.125% trigger. Back in 2011, just after the crisis, the global framework was less developed and less complex than it is today. When we had to fix this metric we had only two buffers in place, the capital conservation buffer and the countercyclical buffer, the level of the requirements was lower than what it is today. At that time, to define this 5.125%, we simply used the level of the capital conservation buffer as the level which, if breached by a bank, 100% constraints on distributions would be triggered.

It was the result of a compromise and already at that time there were some voices saying that it was probably too low. This debate as to whether we should review the level of triggers has been reactivated, because we now have a more complex framework. We have more buffers and higher requirements and we are in a resolution world — back in 2011 this was not the case, or at least the resolution aspects were not defined as they are today.

In my personal view there are perhaps some merits but also some drawbacks in reassessing or reviewing the level of the triggers now.

Firstly, I do not think there will be an easy answer, because maybe some would even say that 7% may not be enough, and then what would be the right level?

This would then also reopen the capital definitions. It would also reopen the discussion about buffers, capital stacks, and all the different interactions. So it would not be so easy to do.

In addition, in my view we should keep some stability in the regulatory framework for capital, so I would personally not be in favour of this. Regulators are working on the interaction between going and gone concern frameworks. However, at the moment, we do not favour a change in the capital framework since we believe that the current one has proven to be an effective regime. We reaffirmed this recently in public communications with EU co-legislators in the context of the CRR review.

One change that has been introduced — which also came from a recommendation from our side — relates to the point of non-viability, which has now been included in the CRR2. It was missing in the first CRR because when Basel finalised its press release on the point of non-viability, CRR1 was almost finalised. That said, we will not change the level of the triggers for now.

BIHC: We know the regulator has to give its approval for any call. What we understand less is the process for this approval — we assume it's a combination of economics and capital planning. Could you give us more detailed guidance? In particular there is the impression that the economics is coming more to the fore.

Reymondon, EBA: Indeed, from the EBA side, this issue of the exercise of forthcoming calls is something we will be looking at. We communicated on this aspect in our last AT1 monitoring report.

To be more precise, as regulators, we are not the ones to say yes or no to exercising a call — it is more the job of the supervisors. But the EBA did publish, back in 2013, some Regulatory Technical Standards to give indications on what criteria supervisors should consider when assessing an application from an issuer to exercise a call, for example the global situation of the bank, its profitability, its capital planning, and the margin compared to the capital requirements. It is a case-by-case basis assessment, you judge the particular situation of the bank and you check if the bank intends to exchange or replace the instrument. You also need to keep in mind the global market perspective in a way, because it is also important to know if, in case of need, the bank will be able to re-issue at short notice and under which conditions. These are more or less the aspects which are looked at.

We should also bear in mind that there is always a little bit of pressure, also from the supervisory side, because if you refuse the exercise of the call then you may put a stigma on a particular bank, so this is not an easy decision for the supervisor to make.

Delphine Reymondon, EBA

BIHC: Will the supervisor be able to clarify if it actually rejected a bank's request to call an instrument? If an issuer doesn't call a bond they may blame the regulator and ask investors not to punish them.

Reymondon, EBA: If I were still in a supervisory position then I would probably be quite reluctant for a bank to communicate that it is because of my supervisory decision that a call has not been exercised. But I believe that the supervisor should have a dialogue with the bank sufficiently in advance to see if views are aligned. I would expect that there would at least be some convergence in views on the opportunity to call or not the instrument. For banks that are in troubled situations, which have low margins compared to requirements, I believe that investors would probably already make some assumptions that the call may not be exercised. Thus I do not envisage a lot of situations where there would be a big surprise. In addition, if the bank does not want to call for economic reasons, in this case it can be explained without referring to a potential refusal from the supervisor.

BIHC: I understand that in the new CRR2/CRD5 draft there may be new provisions on bail-in acknowledgement for bonds that have not been issued under EU law, and today the market clearly has a new focus on this because of uncertainty regarding the future treatment of UK law AT1. Are there any discussions regarding potential grandfathering of those bonds? We heard rumours about a six year grandfathering period.

Reymondon, EBA: There are several aspects to this question. Indeed, first of all there are — as everyone knows — some political discussions and no one yet knows what the outcome of those will be.

A different aspect is that the requirements of the BRRD, in particular Article 55 statutory bail-in clauses, are already there, so this is not something new. By the way, EBA previously developed a standard clause for bail-in clauses for issuances in third countries. As we said before, the new aspect which will be introduced is the PONV as an eligibility criterion for capital instruments.

Then indeed the question with Brexit is how issuances under UK law will be treated. We issued an opinion a couple of months ago saying two things. The first was that if you want absolute legal certainty on the effectiveness of the clauses or the powers for the resolution authority, the best way would be to issue from an EU27 institution's perspective under EU27 law and under UK law for UK institutions. Otherwise, the solution would possibly be to have a contractual clause. What we have seen in some issuances is some substitution/variation clauses to potentially change the governing law. The issue, which already exists, is that the resolution authorities theoretically have the power to discount some of the capital issuances from MREL if either there is no binding agreement with the third country or they believe that the contractual clause could not be triggered in an effective manner. So there would still be a need for banks to demonstrate to the resolution authorities that this clause would be effective in resolution, and this is of course more difficult to prove. I guess you could have a lot of legal opinions there, but legal certainty would for sure be less than if you issue under EU27 law.

In terms of grandfathering, what I believe is that for all the clauses linked to Article 55, there should be a priori no grandfathering, because it was already in BRRD1. What will be grandfathered a priori is the introduction of new criteria. Even if the grandfathering provisions are still being discussed, the PONV clause would very likely be included within a six year grandfathering period — it is something we recommended as EBA. ●

AT1
Evolving dynamics

Rising yields, volatility and risk premia combined with developments in regulation are posing challenges and questions for issuers and investors alike — just as the first wave of AT1 calls arrives. Crédit Agricole CIB and Bank+Insurance Hybrid Capital brought together the different sides of the market to share their views on how pricing and capital stacks should develop.

Neil Day, Bank+Insurance Hybrid Capital (BIHC): AT1 valuations have moved significantly since issuers like Nordea and Belfius priced euro-denominated AT1s at record reset levels in November 2017 and January 2018, respectively. What are the major differences between the situation back then and today's environment? How do you cope with the negative mark-to-market?

Marc Stacey, BlueBay: The repricing has less to do with the banks themselves — they continue to be well capitalised and asset quality continues to improve. In essence, the repricing has been mainly driven by macro/political factors and a repricing of risk premiums generally. So the value prospect today makes the investment proposition even more compelling.

Over the last 10 years banks have continued to streamline the types of business they are involved in and have increased capital levels. Prior to the crisis common equity made up roughly 6% of banks' risk-weighted assets and today that number is closer to 14.8% on average — in absolute terms over EUR600bn of equity has been added onto banks' balance sheets. We didn't lose nearly that number during the financial crisis, so in essence we've actually added onto banks' balance sheets a buffer that could almost withstand the financial crisis again — I am not suggesting that if we had a repeat of the global financial crisis certain banks wouldn't find themselves in trouble, but it does give you a sense of how much safer banks are today than they've been before.

Given this fundamental trajectory I think AT1 looks particularly compelling, especially when compared to Lower Tier 2, for example. Perhaps the biggest risk differential between AT1 and Lower Tier 2 is the prospect of a non-coupon payment of the AT1, and in some cases one would have to have AT1 coupons missed 60% of the time just to break even with the Lower Tier 2 valuation. So by that metric AT1 looks extremely cheap versus Lower Tier 2.

Jenna Collins, BlueCrest: Even though I totally agree banks look great and I love their credit quality, one has to look at this on a relative basis. We have a situation where rates have been going up in the US, and a two year Treasury — zero risk, basically — trades at 2.7%. This starts to look interesting to people. And that has a cascading effect on other assets.

We still really like top tier, national champion names in AT1 as long as they are priced with a good new issue premium — for example, some of the more recent ones, including Credit Suisse 7.5% and 7.25%. But it's tricky for the second tier banks when zero risk-ish assets become attractive — second tier assets don't then look as cheap anymore.

Neel Shah, Crédit Agricole CIB (CACIB): The market pricing of AT1s overstretched in Q4 last year and at the beginning of this year. Investors we speak to compare the AT1s within the financial space, but with high yield as well, and AT1s are trading 100bp-150bp wide of double-B bonds — they are trading almost like single-B rated bonds in terms of yield. So if you look at the bigger picture beyond the financials universe, they definitely look much more attractive. And we have heard recently about defaults in China and Asian high yield is also underperforming, so we've seen a substantial shift by Asian investors from high yield Asian credits back into AT1s.

Alexandre Birry, S&P Global Ratings: It's true that in terms of fundamentals, banks are better capitalised and balance sheets are more resilient. So I don't think these market developments are driven by banks' credit quality or profitability. Political risk is clearly there, but we saw that last year already, so it is not a new story. The dynamics around interest rates in the US are a more plausible explanation for market conditions.

In addition, while many banks have more or less filled their AT1 buckets, their attention has now increasingly turned to MREL and TLAC instruments. There is probably an expectation in the market that there will be all this supply of new instruments — even if less subordinated — in the next couple of years. And this at a time when the ECB's monetary support is gradually fading.

The roundtable was hosted by Crédit Agricole CIB on 31 August in London, featuring:

Ervin Beke, bank analyst, BlackRock

Olivier Bélorgey, global head of Crédit Agricole group treasury and funding

Alexandre Birry, head of analytics and research, financial institutions, S&P Global Ratings

Michael Benyaya, DCM solutions, Crédit Agricole CIB

Nigel Brady, AT1 trader, Crédit Agricole CIB

Jenna Collins, credit trader, BlueCrest Capital Management

Bernard du Boislouveau, FI DCM, Crédit Agricole CIB

Vincent Hoarau, head of FI syndicate, Crédit Agricole CIB

Sebastiano Pirro, portfolio manager, Algebris Investments

Neel Shah, financial credit desk analyst, Crédit Agricole CIB

Marc Stacey, partner, senior portfolio manager, BlueBay Asset Management

Aarti Vasudeo, senior manager, capital issuance, ratings and debt IR, Lloyds Banking Group

Moderator: Neil Day, managing editor, Bank+Insurance Hybrid Capital

So for me, monetary policy and the industry's overall issuance requirements are some of the main elements driving the market changes, rather than bank fundamentals or even political risks.

Ervin Beke, BlackRock: To answer to your question as to what's different to six months ago in AT1s, it's really convexity. It wasn't priced in in January. Now it seems to be more rationally priced and the main driver of developments — apart from all the other macros factors that have been mentioned.

Nigel Brady, CACIB: One of the approaches to pricing that we now use is to look at the current financing core funding rate for AT1s as opposed to where the existing secondary bonds are, because they are clouding the relative value and performance of AT1s — if you are using Nordea or Belfius, for example, they clearly make the AT1 market look much worse this year than it is. If you actually look at the underlying core finance rate, it isn't that much wider than it was at the beginning of the year. It's just that all the bonds that were issued at a tighter level due to this convexity effect are obviously impacted harder.

Vincent Hoarau, CACIB: Coming sub-300, Belfius's reset spread was quite punchy. In January there was a striking imbalance between supply and demand in the AT1 market and clearly there was a sort of frenzy in the air. The market was pricing only good news, everyone was positioned for a goldilocks scenario.

Then we had the first shock, with rates pushed higher in the US by a more hawkish Fed on the risk of an overheated US economy. But the greater catalyst for the correction was Italy and the shock it implied for VAR models, and the spill-over effect across the board. Lastly, the ongoing rhetoric around a trade war simply stimulated the volatility of the equity markets to which AT1 instruments are highly correlated.

As everyone has said, what has changed is the level of volatility driven by macro events, and the reward requested by investors to load mark-to-market risk in the investment book. We have moved from a liquidity-driven market to a macro, fundamental-driven market with a greater AT1-bank equity correlation.

Now, with the intensification of EM risk, idiosyncratic risks are set to return, i.e. more pronounced discrimination and differentiation. And some names are clearly much more exposed than others.

Also bear in mind that AT1 now face the competition of other high yield products which suffered massively throughout H1.

Aarti Vasudeo, Lloyds: 'The call policy is based on an overall capital management perspective'

But the strong appetite for the asset class is intact, providing that valuations make sense.

Day, BIHC: We have the first wave of AT1s coming up to their first call dates. What have issuers' Tier 1 call policies been until now?

Aarti Vasudeo, Lloyds: Generally we look at it in two separate buckets. One is legacy stack Tier 1, and the other is the AT1 instrument. We know the legacy stack is not going to count towards regulatory capital beyond a certain point, so the drivers for calling or not calling such instruments are how they will be treated.

For the AT1 instrument, it is assessed on an economic basis, does it makes sense from a capital stack perspective, how can we optimise the overall capital stack, is there any more bucket filling to be done as RWAs move, etc? So the call policy is based on an overall capital management perspective.

> The strong appetite for the asset class is intact

Olivier Bélorgey, Crédit Agricole: We have systematically exercised our call when the instrument has no more regulatory value or when, for example, the instrument had a step-up. For example, in November 2015 we exercised a call on a legacy Tier 1 bond that had a step-up — complying, in a sense, with the original deal that was made with investors, because when these instruments with step-ups were originated clearly the implicit intention was to call the instrument.

Beyond that, last year we launched a liability management exercise for a perpetual deal without any step-up, proposing to investors to buy back the bond at 95, bearing in mind that the original deal with investors was that it could be perpetual. We noted when launching this liability management exercise that our policy is first of all to maintain a medium and long term relationship with investors, so in a sense to be investor-friendly. That doesn't meant that we will call a bond if it's clearly to the detriment of the bank, but we want to have a combined approach between this medium to long term relationship with investors and, of course, our own interest.

Stacey, BlueBay: It is important for investors to understand what the economics behind the call or the non-call are. Take AT1 as an example: I think that the decision of whether or not to call that bond should be based on significantly more than just the market conditions prevailing at the moment of the call and the reset spread. If a bank issued a bond at, say, mid swaps plus 500bp and since then profitability has improved at the bank and the capital position is stronger, but because of exogenous market conditions external to the bank — call it Turkish lira volatility or Italian political turmoil — risk premia generally have risen and the reset spread to issue a new bond today is wider than the reset spread of mid swaps plus 500bp; it would be very difficult for investors to understand why that bonds wouldn't be called given the improvement in the bank's metrics since it was issued. As a result, issuers should think more holistically about their entire curve and capital structure, including the cost of equity, instead of just a particular bond and its respective reset spread at one point in time.

Collins, BlueCrest: I'm an investor and I don't find it hard to understand their position — they're going to do what they need to do for themselves, right?

Stacey, BlueBay: Absolutely. But what is that? Is it not calling that bond? Let's say on that day they can only issue at mid-swaps plus 550bp.

Collins, BlueCrest: So for them it doesn't make sense.

Stacey, BlueBay: Doesn't it? Longer term it actually raises their cost of capital, because as soon as they don't call that bond, then as an investor I sit back and I think, OK, so if at mid swaps plus 500bp they don't call the bond, that's got to be the floor now for where their AT1 bonds should trade and I'll need a premium over and above that if they want to issue another AT1 bond.

Collins, BlueCrest: For now, and then it'll change when market spread/yield levels trade tighter again.

Day, BIHC: What flexibility do banks have from a regulatory perspective on making such decisions whether or not to call? Can you issue an AT1 now because the level is lower than one you might want to call next year? Bearing in mind that your cost of funding might go up permanently if you don't call a bond. Does that go against the spirit of the instrument?

Bélorgey, Crédit Agricole: AT1 remains a very expensive instrument, compared, for example, to Tier 2. If you have much more than the 1.5% bucket, which is the optimum, it costs you a lot of money. So issuing when spreads are low and having an AT1 stack of 2%, for example, would be costly. I don't think that banks generally speaking are ready to carry two times this type of instrument.

Take our issuance strategy, for example. Timing-wise, we issued the highest beta instruments in our 2018 funding plan — Tier 2 for Crédit Agricole SA and Crédit Agricole Assurances — right at the beginning of the year given that market conditions were wonderful — spreads were in a sense too low. Nevertheless, we haven't yet issued an AT1 ahead of our next call, in September 2019, partly because we don't know what market conditions will be then — perhaps they will be just as good — and also considering the cost of the double carry.

Day, BIHC: Would the regulator question you if you called an AT1 without having a replacement strategy even if you are still above the 1.5% level?

Vasudeo, Lloyds: The regulatory approval takes three to four months ahead of any call and any market notice. So banks will start thinking well in advance about when they should refinance — if they do need to refinance at all — and have a discussion with the regulator.

Pirro, Algebris: That would kill the economic argument, though, because it would mean that you basically have to prefinance your issue before you actually call it — then it would be economic 100% of the time, because you would have double the capital.

Vasudeo, Lloyds: There will definitely be some carry cost, but the question is how much you can you minimise that, taking into account the regulatory requirements and the bank's appetite to take carry cost.

Pirro, Algebris: But the regulator will not stop you from issuing more capital, because that's your decision.

Vasudeo, Lloyds: No it wouldn't, but it can stop you from calling a bond before you have actually issued a bond to ensure capital ratios do not go below certain levels.

Pirro, Algebris: But you have to issue beforehand, that's the point.

Bélorgey, Crédit Agricole: No, I don't think so. For example, many banks don't have 1.5% of AT1. This means that, at least temporarily, you can weaken your capital structure a little bit, at least by perhaps calling one issue.

Pirro, Algebris: My experience on this is that it depends a lot on where you are. In the UK, for example, no one has less than 1.5% and you are not allowed to go down. What we aren't clear about is Europe, which is much bigger and much more diversified. As you say, there are circumstances where it is conceivable, but my hunch would be that you are not allowed to go down. You shouldn't necessarily look at the worst, because institutions still have to strengthen. You have to look at the best, and my thinking is that Europe will follow the UK. Best practice has always come from the UK. The system is transparent and clean, and from the perspective I would assume that is the way it will work in Europe, too.

Sebastiano Pirro, Algebris: 'You have to look at the best, and my thinking is that Europe will follow the UK'

Stacey, BlueBay: Correct me if I'm wrong, but when I've had the opportunity to speak to any regulators, I've gotten the sense that they don't want to be micromanaging banks. Where possible they'd like banks to be able manage their own capital, and as long as it doesn't impact solvency or profitability materially then the decision to call a bond is really at their discretion, and they would only restrict the issuer if it really effected the capital or profitability of the bank.

> Regulators don't want to be micromanaging banks

Bélorgey, Crédit Agricole: I cannot speak on behalf of my peers, of course, but I can perhaps give you some thoughts. We generate CET1 each quarter and banks in general probably generate in a quarter or semester enough CET1 to call one AT1 issue. If in your capital planning you tell the ECB that you will call the instrument but that you have no increase in RWA and so on and that due to the increase in CET1 your Tier 1 ratio remains the same, I don't think there is any reason you couldn't call the bond, and without being obliged to prefund.

Beke, BlackRock: But as a funding manager, if you are managing a bank that has an optimised capital structure — i.e. you've filled your buckets, you don't have excess capital — would you want to refinance an AT1 before calling it? Or would you wait?

Bélorgey, Crédit Agricole: To be honest, if you prefinance one, two, three months ahead of course you sleep better. Any later,

Ervin Beke, BlackRock: 'It's really technicals that will matter in the short term'

and, depending on market conditions, you may have to accept a little more weight on your shoulders. So I would prefer to prefinance — but I think I could sleep all the same even if I didn't.

Beke, BlackRock: Aarti mentioned that the whole call discussion with the regulator starts three or four months beforehand — would it be the same with the ECB?

Bélorgey, Crédit Agricole: I cannot answer that because we do not yet have that kind of discussion with the ECB. What I know is that when I have to call an instrument I have to send the ECB my capital planning each time. So when we announced the call of the Tier 2 CoCo for September three months ago we had to tell the ECB we wanted to call that instrument and explain our capital planning for the next three years.

Brady, CACIB: If financing spreads were considerably wider in the three to four months before the call date of, say, the 2019s, would you then look at say a similar liability-management type option for the AT1s as for the legacy Tier 1s?

Vasudeo, Lloyds: From an issuer perspective, we assess how to best optimise the capital stack, and how to reduce the coupon cost or the spread for the bank overall, because most banks will manage their book on a spread basis. So if the reset spread is higher than what you can actually issue right now, then banks would look at refinancing. Obviously execution certainty and other external factors are considered.

Hoarau, CACIB: But we had a good example this year with KBC. It was a very good idea to look at refinancing some of its outstanding debt despite the added cost of carry. They managed to issue perpetual non-call 2025 in April with a reset spread well below the 400 mark. This would not be possible in the current spread complex.

Pirro, Algebris: Would regulators and issuers consider the potential repercussions on other parts of the capital structure as part of the call/non-call decision?

Vasudeo, Lloyds: Yes, absolutely. Calling or not calling a bond will also have implications on other parts of the capital stack and funding stack, too, so that's taken into consideration while discussing this internally.

Collins, BlueCrest: If I can make one point — which kind of goes back to Marc's original point — which is that what's missing is transparency on exactly how economic decisions are made. It's not clear what different factors are considered.

Issuers have Pillar 3 and other disclosures that are required by the regulators. But it would be good if issuers could just be much clearer about what the economic factors are for AT1 — capital attribution, spread level, swapped spread level — and disclose them in quarterly or semi-annually, maybe with the fixed income conference calls, in an addendum or something. Certain AT1s and other instruments have foreign exchange costs embedded, for example a sterling or euro-denominated bank that issues in dollars. If there is a big currency move, the issuer might find it doesn't make sense to call depending on the details on how it was hedged and accounted for but a euro-denominated bond might be called.

It shouldn't be a guessing game and the fact that there are these ongoing questions about what is going to happen is a concern. It takes a lot of time to keep asking issuers over and over how they make their economic decisions. It would take less time for everyone if disclosure was made on a semi-annual or annual basis.

> **Issuers are thinking about this in completely the wrong way**

Vasudeo, Lloyds: It's bond-specific.

Collins, BlueCrest: You could do a line for each bond — based on current levels, this is what the economics look like to us, the issuer.

Day, BIHC: What if an issuer plans to refinance calling a 5% bond next year by issuing a bond at 7% in a month's time? Arguably that's not economic on a one-for-one basis, but does that 2% a year significantly affect the profitability of the bank? Will the regulator say it is against the spirit of the instrument?

Vasudeo, Lloyds: From an issuer perspective, economics of the call and the impact on profitability are primarily considered.

Stacey, BlueBay: I think issuers are thinking about this in completely the wrong way.

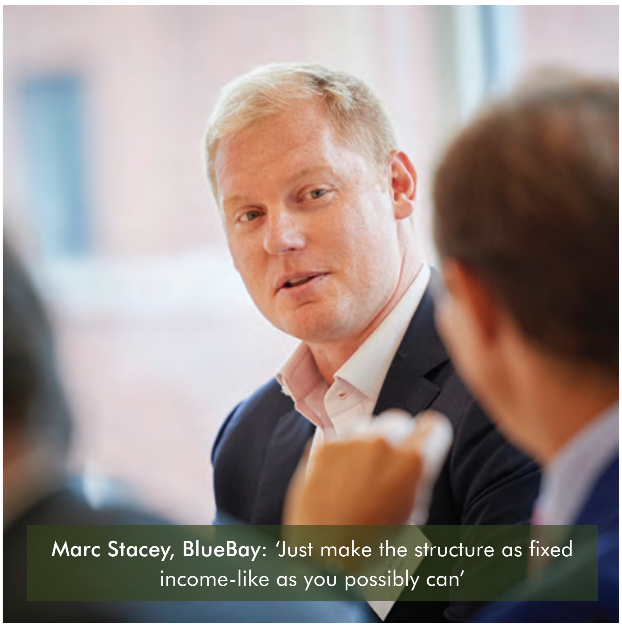
You say it's expensive Lower Tier 2, but the way I look at it is, it's extremely cheap equity for you. It's actually a gift from the regulator, in that you can fill a bucket with this cheaper capital which helps with both leverage and your total capital calculation. The alternative to AT1 for you would be common equity, which would be more expensive. So if I were an issuer I would think, well, my going concern capital bucket should just be made up of equity, with AT1 in my gone concern bucket. Essentially AT1 and the old Tier 1 have the same risks in terms of a bail in, and if we think about where Tier 1 traded back in 2007, it got to 69bp. Rightly or wrongly, AT1 has been predominantly sold to credit investors. So if I'm an issuer, I should be thinking, how do I make my AT1 as fixed income-like, as credit-like as I possibly can so it trades like the old Tier 1 of the past? I wouldn't be trying to game features in the terms like conversion to equity versus permanent write-down because I'm not getting paid for equity conversion at the time — just make the structure as fixed income-like as you possibly can, where the seniority of AT1 versus equity is unambiguously clear so it trades tighter in spread, like the gone concern capital it is. And eventually AT1 then makes it into IG and high yield credit indices — because, by the way, when you look at Banco Popular, it didn't matter whether you were in the equity, AT1, Lower Tier 2, and if they'd had any senior non-preferred that would have been haircut as well — so either Lower Tier 2 or senior non-preferred shouldn't be part of IG and high yield indices, or AT1 should, as the regulator treats them in the same way once a bank has been deemed failing or likely to fail. For issuers, the game-plan here should be to try to get AT1 as tight as possible, treat AT1 like credit not equity, in which case it will become an even cheaper source of capital and as a consequence improve profitability at the bank.

Looking at it on a bond by bond basis makes no sense at all, because as soon as you don't call a bond, against Lloyds I'd have, OK, you didn't call a bond at 400bp over, that's the floor for your spreads.

Bélorgey, Crédit Agricole: If you can tell me how many basis points I save if I call a bond — even if it is from a pure economic, short term maths perspective non-economic for me — I will give you more clarity on what is economic for me in a broader sense. But you don't give me that information.

Beke, BlackRock: If the regulator does not necessarily allow non-economic calls, then as an investor I will price you based on the assumption you will act in a purely economic way. Once the regulator allows them, then I will start giving credit to guys who actually have a strong policy and will call instruments, in which case I will price them to a shorter end date.

Bélorgey, Crédit Agricole: Again, we've not yet had that kind of discussion with the regulator, but my personal feeling is that I would be totally confident in being able to explain to the ECB that I am calling an instrument because my economic approach is the pure difference between the new issue spread and the reset spread and the impact on my future issuances. I think this is totally rational, and if the difference between the two spreads is reasonable, my feeling is that the ECB could accept this argument. Of course, if the difference is, let's say, 200bp, it would be hard for me to convince them that investors' attitude towards this is worth so much. So there would an area where I wouldn't expect the ECB to intervene, an area where the ECB would challenge the issuer a lot, and perhaps a grey area where it is not clear how they would react.



Marc Stacey, BlueBay: 'Just make the structure as fixed income-like as you possibly can'

Day, BIHC: Alexandre, does any of this affect your angle?

Birry, S&P: If I can start with the obvious: not calling is not an event of default. It's perfectly permissible under the terms of the instruments.

For us, permanence is a key element of our criteria for granting equity content to an instrument. We may grant equity content to an instrument with call features, but on the premise that the issuer has full flexibility not to call the instrument, whether it's for economic reasons or others.

Some issuers may be erring on the side of caution

What we now see happening is a normal reflection by issuers willing to exert their discretion — after consultation with their supervisors. Issuers' readiness not to call has been more prevalent in other parts of the world and other industries, but it is now being tested in Europe.

Obviously, if not calling instruments led to a material and persistent deterioration in the overall cost of funding of an issuer, then we might not grant equity content to these instruments. It's a hard call to make, and at the moment we haven't seen that happen in practice. But some issuers may be erring on the side of caution — at least for now.

Day, BIHC: How could do you manage any FX volatility arising from hedging swaps for AT1 and how might that affect the call strategy?

Alexandre Birry, S&P: 'Grandfathering does matter and it should actually help at least smooth the transition'

Vasudeo, Lloyds: We definitely want to be a multi-currency issuer, across our capital stack and debt stack, and this is definitely a consideration for us. It is embedded in our planning in terms of impacts of calls, maturities and issuances, specifically because the UK AT1s are all equity accounted, which create volatility given the way they are accounted. So it is definitely high on our list of considerations.

It's basically a timing mismatch, because it just doesn't go through P&L, and you just get the hit at a later date, so that is considered when we plan for the next four or five years — we are conscious that there will be a call coming up, that if that bond is called then there will be certain impact on the P&L.

Clearly some instruments on the market do not tick all the boxes

Bélorgey, Crédit Agricole: In terms of interest rates, we have always hedged our issuances, so our call policy — at least for the pure mathematical economic part — is based on spreads, not absolute rates. And for the issuances we have made in dollars, we also have hedged the issuance, meaning that we didn't want to have P&L volatility — because the instrument is equity accounted, so if you do not hedge, you have P&L volatility coming from the other elements of the balance sheet — so we have hedged that. Doing so increases the sensitivity of your CET1 to forex moves a little bit. But it's already, each quarter, integrated in our CET1 ratios. So because we have hedged the forex risk of these instruments, we have a little more volatility in our CET1, but it's only some basis points in fact, so it's not really an issue for us. And at the end of the day, because it doesn't go through the P&L, for us forex risk won't impact our call policy. So what you need to know is that our call policy — at least the purely economic part of the equation — is only based on the spread.

Stacey, BlueBay: That's key as an investor, the investment decision should be simple for credit investors: you buy a bond, you get paid a coupon, you get par at the end. If we're starting to have to analyse what the bank did on its FX swap and having to implement that into our analysis, then there needs to be a much bigger premium for what we charge for your bonds. It's as simple as that.

Collins, BlueCrest: Or you could provide very clear information.

Stacey, BlueBay: Sure, but you need to have the information to be able to price it.

Day, BIHC: What are the most recent developments in terms of AT1 eligibility criteria in CRR2? How could this affect the outstanding stock of AT1?

Michael Benyaya, CACIB: The new draft for CRR2 and CRD5 proposes to include new eligibility criteria for both AT1 and Tier 2, notably in terms of set-off and bail-in acknowledgement.

In terms of set-off, there may be a need to include a formal contractual set-off waiver in the documentation. We need to see the final form of the text to see if it's really going to be necessary or not — it's unclear at this stage.

In terms of bail-in acknowledgement, this will be necessary for bonds issued under non-EU law, so maybe New York law and potentially English law post-Brexit. It may be necessary to change the documentation of some AT1 and Tier 2 instruments to introduce this bail-in acknowledgement. I'm not a lawyer, but I don't think it's a major change for investors, because it was already part of the instrument that it be subject to bail-in, so if it were to happen it would be only a kind of cosmetic change — it will not change the underlying risk of the instrument. But clearly some instruments on the market do not tick all the boxes, so here and there some action is necessary from particular issuers.

It is also worth bearing in mind that the new draft foresees some grandfathering provisions. Currently it's six years from 2019, so until 2025. If that's ultimately confirmed it will help ensure a smooth transition towards the new criteria.

Day, BIHC: Alexandre, have you been looking at this issue?

Birry, S&P: It is relevant for us because regulatory classification as AT1 is a necessary though not sufficient condition for us to give equity content to instruments. So for instance if an AT1 instrument meets our other criteria to be included in capital then we also look at the regulatory classification and if it's 100% AT1, perfect, that's the last condition and we can include the instrument in our analysis of capital for a bank. We therefore follow the grandfathering rules, and if there is, for example, pro rata treatment that reduces acknowledgement as AT1 over the life of an instrument, we would also follow this trend. That would be the approach we would take, so therefore grandfathering does matter and it should actually help at least smooth the transition.

Day, BIHC: Could grandfathering introduce a de facto final maturity on perpetual AT1 instruments and therefore discredit their perpetuity feature?

Benyaya, CACIB: It's difficult to give a final view until we see the text that has been voted by the parliament. But if some instruments are clearly identified as non-compliant with the new regulation you could question the perpetuity. However, this does not necessarily mean they will be called at the end of the grandfathering period — there are some other factors that can come into play, like rating agencies' model eligibility, for example. So yes, you could question the perpetuity of some instruments, but again you have to be careful, and there are some factors affecting the entire capital structure that can come into play.

Day, BIHC: Do you see trigger levels for AT1 evolving?

Stacey, BlueBay: If you think about all the restructurings that we've had in the sector, they've all been executed with CET1 ratios above 7%, right? So you can argue that even at 7% the trigger is too low. This goes back to my point that AT1 is gone concern capital. I mean, does a bank want to turn off a coupon to recapitalise itself? No, it makes no sense. There's a big German bank that could save EUR300m-EUR350m if it turned off a coupon — but it would do nothing to recapitalise the bank, and yet it would reprice not only its capital structure, but other core European banks' capital structures. So I think it's almost dawning on the regulators more and more that actually this is gone concern capital and common equity is going concern capital.

Vasudeo, Lloyds: I agree. For UK banks the 7% trigger is a requirement. It has little meaning given the regulatory framework has evolved so much. When AT1 was introduced, it probably made sense, but given the fact that now there is a need to bolt on the MREL stack on top of capital, the AT1 trigger is irrelevant. In reality everything will go down at one point.

The regulators know very well that low trigger is gone concern capital

Shah, CACIB: I think the regulators know very well that low trigger is gone concern capital. If you were really serious about it being going concern, it would probably have to be a 10% principal trigger level. But at this moment in time they are focused on building the total capital of banks as opposed to the trigger levels. I can envisage it changing, but it's going to be 10 years down the line when banks are in a different situation in respect of their total capital structure.

But whether 5.125% or 7%, it's too low. We have been discussing call features and previously we were talking about coupon risk; principal risk was never at any point really a concern for AT1 investors because it's so out of the money.

Pirro, Algebris: The whole point of this was to have a prefunded rights issue on the balance sheet and not have to take any decision, right? So the regulator understood it was weak, and it could not actually force something to convert into shares early.

But now it is clear that a number makes no sense, because the numerator might change — as it did — but the denominator of the capital ratio is changing, too. And that number is completely arbitrary, decided by the G20 at a roundtable. Your capital ratio can fall substantially — such as in the UK, where mortgage risk weights are going up a lot — but the risk of that issuer is not changing.

Because the system is moving so much, it doesn't make any sense to change the trigger now. Any number would be as arbitrary as the precedent. The understanding is that the trigger is irrelevant, and we all understand that.

Olivier Bélorgey, Crédit Agricole: 'We could show investors that we believe in our institution'

Day, BIHC: The trigger features were nevertheless discussed when the market was developing, for example when CASA used a dual trigger.

Bélorgey, Crédit Agricole: When we issued with this dual trigger, it was in order to demonstrate our strength. We were not forced to include the high trigger, 7%, at the group level, but did so in order to be compliant with best practices that had been established by the UK. And we could show investors that we believe in our institution and want to build such high capital ratios that we have no concern about issuing with a high trigger. We also wanted to introduce the dual trigger to better explain the structure of the group, how capital circulates between the regional banks and Crédit Agricole SA as the issuer.

But I totally agree with what has been said. Today 7% is for many institutions — at least for our institution — below the Pillar 2R requirement.

Day, BIHC: What are the implications of the abolition of Dutch tax deductibility of AT1s?

Birry, S&P: My main question is, will other countries follow suit and if so, when? The news came out at the end of June and it was clearly stated that the European Commission pushed for this change, on state aid grounds. It is therefore possible that other countries may have to follow suit. At the same time, we all know how complex it is for a country to change its tax legislation, and even more so to harmonise that at a European level. So indeed everyone is wondering what it means outside the Netherlands.

If this was adopted more broadly, for European banks, it would represent another hit to be absorbed by the P&L at a time when profitability is still sub-par. To put it into perspective, the Dutch initiative is expected to bring an additional EUR150m of tax revenues into the coffers of the Kingdom of the Netherlands. It's another pain point for ROEs, but manageable when spread across the country's main banks and insurance companies.

Beke, BlackRock: I think the question is not the validity of the instrument, but rather how issuers would think about the economy of tax calls. Would they call a high cash price bond to get a gain through re-issuing it at a lower spread? That's a risk for their bonds. But for the sector it doesn't really matter.

Hoarau, CACIB: In terms of market reaction, I remember when the news came out you saw AT1 from ABN, Rabo and ING take a dive, but they recovered fairly rapidly as soon as issuers made a formal statement that they would not approach the market on the back of this news in an opportunistic manner and exercise the tax call. So at the end of the day it was a non-event in that respect.

Collins, BlueCrest: When I spoke to issuers they kind of groaned, they issued their statements, then they said: "Ugh! This is another cost for us." That was the main takeaway I got.

> Everyone is wondering what it means outside the Netherlands

Vasudeo, Lloyds: Yes, agreed. From an issuer perspective, it's not welcome. We are closely following it. We haven't heard anything in the UK specifically on this.

Bélorgey, Crédit Agricole: I don't know if this is an issue that is the same across the different jurisdictions, because from what I know, the origin of this ruling in the Netherlands comes from the fact that there was a difference between the taxation of banks and insurance companies on the one hand, and corporates on the other — which is not the case in France. So, for the moment in France we don't think there is a reason to be concerned by that development.

Benyaya, CACIB: It's true that in many countries there is no specific rule for the treatment of AT1 coupons, and in that context it would be difficult for the Commission to pinpoint specific issues in those countries. In some other countries — I'm thinking the UK and Germany — there has been a specific ruling for the AT1 coupons, so there could be an issue there. But elsewhere I don't see any spillover effect.

Day, BIHC: How do you see the use of AT1 and Tier 2 in the capital structure evolving going forward?

Benyaya, CACIB: I will again refer to the CRR2 because there are many elements in that draft that are of interest. Under some regulatory metrics, like large exposures and also what we call the standardized outlier test, there is a restriction in the use of Tier 2 capital, so some issuers have questions about the use of Tier 2 and the need to maintain a significant buffer of Tier 2 capital.

Vasudeo, Lloyds: There will be limited use for Tier 2. It has an impact on pricing in the capital stack. Ticking the regulatory box is one of the main things from an issuer's perspective. But I think increasingly Tier 2 will lose more and more of its value.

Shah, CACIB: The UK regulator is much stricter in terms of leverage ratios than in continental Europe. I don't think the leverage ratio can remain at 3% in continental Europe, so AT1 as an instrument will be more important going forwards, and banks will have to issue more than the minimum 1.5%.

Vasudeo, Lloyds: Absolutely. In the UK we assess the volume of AT1 that we issue against the leverage ratio and minimum capital requirements, too, so on an RWA metric and the leverage metric. It could be a binding constraint based on the business model of the bank.

Bélorgey, Crédit Agricole: It is efficient to have at least 2% of Tier 2. Beyond that, the efficiency of Tier 2 in different constraints is indeed declining as Michael described. So everything being equal, the incentive to issue Tier 2 is lower.

I also agree that we have to assess what kind of other benefits we can have. With TLAC, if you only take CET1 plus AT1 it leaves still a lot of space for Tier 2 and senior non-preferred or HoldCo. I'm not sure that the optimum amount of Tier 2 is 2% with the remaining requirement comprising senior non-preferred or HoldCo, because in that case I'm not sure the thickness of the Tier 2 layer would be sufficient to justify an interesting price — at least for the issuer — for senior non-preferred or HoldCo. So my guess is that, everything being equal, the efficiency of Tier 2 will diminish, but 2% will probably not be the optimum in terms of building the capital structure. More than 2% could be more efficient because if you have, for example, 3% of Tier 2 it helps to lower the price for senior non-preferred or HoldCo debt. But, once again, we will build this together — it also depends on how investors price it.

Regarding the single lending limit, the fact that CRR2 intends to remove Tier 2 from counting towards this is not good news for European banks, because it will lower the capacity of European banks to support their biggest clients in their corporate acquisition deals. It is something that we have to lobby against. ●

The end of corporate hybrids?

An IASB proposal to reclassify the popular perpetual cumulative corporate hybrid structure as liability has cast a shadow over the primary and secondary markets since its release in June. Here, Véronique Diet Offner, in charge of liability management for EMEA and corporate hybrid structuring, DCM solutions and advisory, Crédit Agricole CIB (CACIB), shares insights from concerned parties on the implications for outstanding and future issues and ways to mitigate the impact of the change.

2018 may be remembered as a two-sided year for the corporate hybrid market.

The year started with the welcome release by S&P of a revised methodology on the early replacement of hybrids. Before this revision, issuers were not allowed by the agency to replace their outstanding hybrids before their fifth anniversary. With this new methodology, S&P allows issuers to actively manage their hybrid stock without time constraints as long as the replacement instrument has at least the same equity content, and the quantum issued is at least of the size of the nominal amount repurchased. Several hybrid issuers have since taken advantage of this revision and have launched large replacement exercises across their hybrid curves to try and optimise the financial conditions of replacement — examples include Telefónica, EDF and ENEL, with CACIB acting as dealer manager for the latter.

However, the second key event for 2018 has been casting a shadow over the market since July: the Discussion Paper on Financial Instruments with Characteristics of Equity released by the IASB at the end of June presents a new preferred approach on the classification of the perpetual cumulative corporate hybrid structure. This approach would jeopardise the equity classification of this structure at a time when it represents over two-thirds of the corporate hybrid market.

In this context, CACIB in mid-October organised a roundtable on corporate hybrids focusing on the impact of the IASB discussion paper on the corporate hybrid market and its various stakeholders.

IASB board member Mary Tokar offered a comprehensive explanation of the preferred approach and confirmed what a large part of the market had understood, i.e. that perpetual cumulative hybrids (as typically structured) would be classified as liability if the preferred approach were to be implemented. Indeed, the IASB is contemplating developing an "amount feature" on top of the "timing feature" already in IAS32, to provide guidelines for the classification of instruments as either equity or liability. According to this new approach, a financial instrument would not meet the amount feature and would thus be classified as financial liability if the issuer promised a return to the instrument's holder that had any independence from the issuer's own performance or share price. According to the IASB, this would be the case for cumulative hybrid securities because the coupons, if deferred, accumulate for payment at liquidation.

> **'It represents over two-thirds of the market'**

The potential shift in classification from equity to liability under IFRS would be an obvious issue for non-rated hybrid issuers, as highlighted by Arnaud Kolb, group treasury and financing manager at Eurofins Scientific: "Perpetual hybrids have historically represented an economically efficient tool for non-rated issuers to finance external growth without breaching covenants and without diluting shareholders."

However, it would also be an issue for rated issuers who were not only interested in the 50% equity content from rating agencies but also in the IFRS equity classification.

Regarding timing, the IASB did not wish to commit to a calendar, but mentioned that considering the nature of the consultation process, implementation before 2024 seems highly unlikely.

"The IASB is currently in the first step of this process, with stakeholders being invited to provide comments on the Discussion Paper until January 2019," said Tokar.

The discussion paper has, however, already started affecting the primary and secondary markets, and in particular asset managers' investment policies.

Highlighting the impact on the secondary market, Victoria Whitehead, senior credit portfolio manager at BNP Paribas Asset Management, who is in charge of a fund investing in investment grade hybrids, said: "We have always been mindful of the early redemption risk in corporate hybrids, in particular due to the rating and accounting calls in their documentation. Hence, when investing in the secondary market we tend to favour low secondary price hybrids and have been even more

Mary Tokar, IASB
'Perpetual cumulative hybrids may be reclassified as liabilities'

selective since the release of the discussion paper. As far as the primary market is concerned, we are screening all new issues and analyse whether they have a first call date likely to be post the implementation of the IASB preferred approach."

A large majority of perpetual hybrids are rated and Gregg Lemos-Stein, global head of analytics and research for corporates at S&P, indicated that S&P's corporate hybrid methodology should not be impacted by any change in accounting treatment.

Nevertheless, some rated issuers who opted for perpetual corporate hybrids, not only for the rating agencies' 50% equity credit but also for their IFRS equity treatment, may decide to exercise their accounting call (option allowing the issuer to call the instrument at 101% in case of reclassification of the instrument from equity to debt) when and if applicable.

Is that the end of perpetual corporate hybrids as a tool for issuers looking for IFRS equity?

One structure may still be considered as essentially equity: the perpetual non-cumulative structure. Such bonds are likely to be differentiated from cumulative instruments as the issuer would in this case be under no obligation to pay a coupon and the instrument would contain no unavoidable obligation to pay any amount independent of the issuer's available economic resources. For these instruments, the notional of the bond would still be considered as liability under the preferred approach, as upon liquidation investors would have a claim on it. However, the present value of the nominal amount would normally be insignificant under the going concern approach and hence the difference between the issuance proceeds and this present value may be recorded under equity.

From the rating angle, S&P is likely to analyse a perpetual non-cumulative hybrid in overall the same way as a cumulative hybrid and thus treat it as having 50% equity content, so long as it meets all other aspects of the agency's criteria.

From the issuer's point of view, Kolb at Eurofins Scientific highlighted that "any 'new' IFRS-compliant structure (whether the non-cumulative structure or any other that might meet the issuer's constraints and objectives) may be efficient provided its cost would make it an attractive way of raising IFRS equity for the issuer".

Damien Loynes, European head of corporate syndicate at CACIB, mentioned that order books for a corporate non-cumulative hybrid may differ from the order book of a cumulative hybrid. Indeed, on top of any investment guidelines restrictions, the fact that non-cumulative structures are unlikely to pass the IFRS9 SPPI test may be a major negative for insurance investors, which can typically represent around 20% of the books of investment grade hybrids. The need for deal-related roadshows may be more relevant than ever to gather visibility on the premium over the cumulative structure required by investors who will accept this new feature.

How can the various stakeholders be expected to manage the transition period?

IASB board member Tokar indicated that "if the preferred approach were to be implemented, it is unlikely that the Board would consider grandfathering for the outstanding perpetual hybrids not meeting the new criteria".

On this basis, Kolb and Loynes highlighted the benefits of liability management strategies for issuers, whether in the context of replacement exercises or consent solicitations to modify the terms of existing hybrids (depending on their documentation and governing law).

Victoria Whitehead, BNPP AM
'We have been even more selective since the release of the discussion paper'

Whitehead at BNP Paribas AM said: "We generally consider liability management exercises on hybrid bonds positively as they bring liquidity and a premium over secondary prices. We thus tend to participate if we consider that the premium offered by the issuer to repurchase its outstanding hybrids is attractive enough, especially if we wish to invest in the replacement instrument."

Permanence is a key pillar of S&P's corporate hybrid methodology and S&P will ask issuers to give it visibility on their intention regarding accounting calls if they have hybrids with first call dates beyond the date when a change in accounting classification is expected. However, Lemos-Stein pointed out that "if there is no available or affordable alternative replacement structure for an issuer with outstanding hybrids, S&P would not consider replacement to be mandatory following an accounting call since the economic rationale for the instrument has changed".

Overall, the roundtable confirmed that the IASB's new preferred approach would impact significantly non-rated issuers but also rated issuers who require the IFRS equity treatment.

Nevertheless, if it is confirmed that non-cumulative structures (and potentially others) can be overall equity accounted and are cost-efficient, then most issuers should find a way to manage the transition without impacting investors too negatively, potentially via the use of liability management exercises. ●

Portugal
Reaping the rewards

Moody's rewarded Portugal's economic recovery with a return to investment grade in mid-October. In the wake of the positive news, *Bank+Insurance Hybrid Capital* sought issuer, investor and rating agency views alongside insights from Crédit Agricole CIB on the story behind the upgrade and how it could affect Portuguese banks' issuance in challenging markets.

Neil Day, Bank+Insurance Hybrid Capital (BIHC): Moody's upgraded Portugal to Baa3 on 12 October, citing a broadening of Portugal's growth drivers as a key factor alongside an improvement in the trajectory of government debt. How is Portugal's better economic outlook playing through in the banking sector, which Moody's said shows greater stability?

Bruno Costa, Caixa Geral de Depósitos: The economic performance of Portugal has certainly contributed favourably to the banking system in several ways. On the one hand, new credit concession has increased over the last three years, although in net terms credit growth as a whole is still negative. This is a consequence of the overall deleveraging that has taken place in the Portuguese economy since the Assistance Programme led by the Troika from 2011 to 2014. This also causes banks to be very comfortable in terms of liquidity, which is a positive aspect. The pace of deleveraging is decreasing, so I believe we are close to seeing a turning point in terms of credit growth becoming net positive. Another positive aspect is that the recovery in the real estate market has helped banks dispose of non-performing assets in their balance sheets.

Christine Passieux, BNP Paribas AM: Whilst witnessing positive developments in 2017 — i.e. an increase in profitability and operational efficiency as well as a significant reduction of the stock of non-performing loans — the Portuguese banking system still exhibits some vulnerabilities, with high exposure to the sovereign and the real estate sector, as well as a significant level of non-performing assets. In that context, an upgrade of the Portuguese sovereign to investment grade combined with an improved economic outlook are positive factors which mitigate some of these weaknesses.

Firstly, a sustainable, albeit moderating GDP growth trajectory (BNP Paribas economists expect Portuguese GDP to grow 2.2% in 2018 and 1.8% in 2019) and lower unemployment rate are likely to fuel the demand for new loans, which is still fragile. The October lending survey carried out with five Portuguese banks has showed that whilst the demand for loans to corporates remained broadly unchanged in Q3, the demand for residential mortgage loans has increased, driven by greater consumer confidence, housing market prospects and the low level of interest rates. At the same time, most institutions reported tighter credit standards following the recommendation issued by the Bank of Portugal applicable for July 2018 when assessing the creditworthiness of borrowers. While limiting the risks incurred by the banks, this is also likely to constraint lending volume growth.

Secondly, after declining between 2010 and 2013, house prices in Portugal have recovered since then, helped by the increase in household disposable income, declining unemployment, the boost in tourism, and the rise in investment by non-residents taking advantage of attractive residential properties. This recovery in the real estate market has clearly helped banks decrease their NPL stock and sell-off non-performing assets.

Participants:

Rui Coimbra, head of investor relations division, Millennium bcp

Rui Constantino, investor relations, Banco Santander Portugal

Bruno Costa, head of funding and investor relations, Caixa Geral de Depósitos (CGD)

Doncho Donchev, capital solutions, DCM, Crédit Agricole CIB (CACIB)

Joana Guerreiro, head of funding, Banco Santander Portugal

Vincent Hoarau, head of FI syndicate, CACIB

Tristan Lagarrigue, head of credit sales – FraBeLux, CACIB

Christine Passieux, senior financial analyst, BNP Paribas Asset Management

Rodrigo Torres, country head Portugal, CACIB

María Vinuela, assistant vice president – analyst, financial institutions group, Moody's

Neil Day, managing editor, Bank+Insurance Hybrid Capital

Rui Coimbra, Millennium bcp: The Portuguese economy went through a successful fiscal consolidation: the state budget deficit at the end of 2017 stood at 0.9% (excluding the impact of the CGD recapitalisation) and the target included in the 2019 budget points to a 0.2% deficit in 2019, with a surplus forecast for as early as 2021. Also, public debt has been decreasing and moves towards a situation of sustainability, approaching, gradually, 100% of GDP (currently at 124% versus a peak of 130% of GDP in 2014).

Following the 2011-2013 recession, economic activity is now strong, with GDP up by 2.8% in 2017 and projections for GDP growth in 2018 are above 2%. Unemployment has decreased significantly from its peak, and now stands at 7.4% (8.9% full year 2017 figures). The current account has turned positive (0.6% surplus in 2017), following deficits of around 10% for most of the decade up to 2010. The real estate market has also recovered.

The Portuguese banking system is concentrated, with the top five banks accounting for circa 80% of the total market, has a comfortable liquidity and capital position, together with a lower, although still elevated, weight of NPLs. NPL coverage by loan loss reserves is also increasing.

Owing to the continued economic recovery, Moody's upgraded the Portuguese Republic and six Portuguese banks, recognising the improvement in operating conditions for banks in Portugal, notably asset quality and capital.

Banco Santander Portugal: The better economic conditions, manifested in the form of growing exports and investment, are clearly positive for the banking sector. On the one hand, because companies have evolved positively, in terms of activity and profitability, with improving economic and financial indicators and lower delinquencies. On the other hand, because it is being reflected in a recovery of credit demand by the most dynamic industries, which are beginning to show a positive evolution despite the overall decline in the stock of credit.

Rodrigo Torres, Crédit Agricole CIB: The positive momentum of the Portu-


Rodrigo Torres, CACIB

guese economy is indisputable. Even if growth is still below the Eurozone average, the socialist government has kept a focus on reducing the public deficit and bringing public debt to a sustainable downward trajectory. And we cannot forget that when this socialist minority government took office in late 2015, with the support in parliament of left-wing parties, many were sceptical on the outcome of this new political coalition never tested in Portugal before.

Exports, which stood at 25% of GDP before the crisis, are expected to represent 45% of GDP this year. This somehow reflects the structural reforms done by the private sector that is being the motor of the economy. Foreign investment is playing a very important role, with the associated recovery in real estate prices that is helping banks reduce their stock of NPEs faster than expected in their own initial projections.

María Vinuela, Moody's: As a consequence of our decision to upgrade Portugal's government bond rating to Baa3, we also changed Portugal's Macro Profile to Moderate from Moderate- to reflect the more favourable operating conditions for banks in Portugal owing to the continued economic recovery. This assessment of a more favourable operating environment for banks, in combination with ongoing improvements in other credit fundamentals, notably asset quality and capital, resulted in rating upgrades by one to two notches, rating affirmations or rating placements on review for upgrade on 16 October for the six Portuguese banks we rate.

Day, BIHC: What are the key recent developments in your individual business outlook and credit story? How are you dealing with the stock of NPAs?

Costa, CGD: Caixa is now almost two years into the implementation of the strategic plan agreed between the Portuguese authorities and the European Commission. The results have been very positive, in many cases beyond the milestones that had been agreed in terms of capital generation, reduction of structural costs, rationalisation of Caixa's presence abroad, and reduction of non-performing assets. On this topic, Caixa's NPL ratio decreased from 15.8% to 10.5% between December 2016 and June 2018 through a combination of sales, cures, write-offs and cash collections. We just completed the sale of a large portfolio of corporate loans which will bring the ratio below 10%. The target agreed with DG Comp is to reach an NPL ratio below 7% by the end of 2020, but in fact our management has an even more ambitious target to reach below 5% in the same period. We believe these targets are very much achievable and the objective is to bring CGD in line with the average of other European banks by the end of the strategic plan.

> **'The positive momentum is indisputable'**

Banco Santander Portugal: Santander Portugal has a lower stock of NPAs vis-a-vis its peers, in view of its conservative risk profile, which allowed it to have a better performance during the economic recession and adjustment period. Currently, we are managing the NPAs received in the acquisition of Banco Popular Portugal in exactly the same manner as we did with the NPAs acquired from Banif, with timely sales in the market of specific portfolios.

Excluding those sales, Santander Portugal's loan book would be registering a mild increase, especially in terms of loans to non-financial corporates, as we have maintained markets shares of around 20% for new loan origination (both in terms of corporate and mortgage loans).

Coimbra, Millennium bcp: BCP is a reference private sector bank in Portugal, well positioned to benefit from the recovery of the Portuguese economy. It's the largest private sector bank in Portugal in terms of business volumes and generates 34% of the system's core net income (NII + fees and commissions — operating costs that include staff, other administrative costs and depreciation).

Millennium bcp has successfully executed an operational turnaround, reinforcing its financial and capital position despite the adverse setting of the banking sector in the core Portuguese market. This position reflects its relentless efforts and the cumulative effect of multiple achievements, such as a 44% cost reduction in Portugal since 2011. BCP has significantly improved its operational efficiency and is now one of the most efficient banks in Europe, with cost to core income ratio at 49% in the first half of 2018.

Over the last five years there was a continued improvement in domestic NII and NIM, supported by the reduction in cost of funding. NIM stands at 1.8% in Portugal and 2.2% for the group in 1H 18.

BCP has significantly strengthened its deposit base, which now represents 88% of total funding. The loan to deposit ratio stands at 88% as of 1H 18 and sets the conditions for loan growth recovery. BCP presents solid liquidity and funding metrics: 176% LCR ratio, 129% NSFR ratio; and significantly reduced ECB net funding to EUR3.1bn as of 1H 18.

Regarding the stock of NPAs, one should highlight the 57% reduction in group NPEs since 2013 through focused NPE management with a dedicated recovery strategy in Portugal: a EUR6.9bn reduction in NPEs, from EUR12.8bn in

2013 to EUR5.9bn in 1H 18. Simultaneously, there was a significant increase in domestic NPE coverage ratios towards circa 50% (106% including collateral) in 1H 18. BCP is reducing on average EUR1.5bn of NPEs per year through sales, recoveries and write-offs — each accounting for one-third of the reduction. The target is to reach EUR3bn of NPEs by 2021. BCP is also reducing foreclosed assets (-11% in June 2018 y-o-y) through sales, consistently (quarter after quarter) above the book value.

Doncho Donchev, CACIB: As reflected in the comments from the banks, the turnaround achieved by the Portuguese banking system as a whole in the space of 2014 versus now in terms of static indicators — such as CET1 and overall capital ratios, NPL/NPE ratios and coverage, Texas ratios, but also in terms of profitability and operating cost optimisation — is remarkable. It clearly reflects the successful performance of the Portuguese economy over this period — Portugal, together with Ireland and Spain are successful examples showcasing that structural reforms work.

What stands out in this context is in particular is the development of CET1 ratios over this period, with some of the banks included here moving from the lower end of the EU banking community in terms of this ratio to comfortably towards the middle, particularly when adjusted for higher RWA densities relative to, for example, northern Europe.

Day, BIHC: How has your capital position evolved and what are your targets?

Coimbra, Millennium bcp: Over the last years, BCP has been able to strengthen its capital base mainly through continued deleveraging, while selectively tapping the markets to raise capital. In January 2017, BCP increased capital by EUR1.33bn through a successful rights issue. This transaction enabled the bank to repay the remaining EUR700m in contingent convertible securities (CoCos) subscribed by the Portuguese government before the mid-2017 deadline, as well as to boost its solvency levels. More recently, through organic capital generation, BCP has enhanced its CET1 phased-in ratio to 11.7% (1H 18), which compares to a SREP requirement of 8.81%, and its Total Capital phased-in ratio to 13.4%, which compares to a SREP requirement of 12.31%. The revised target according to the bank's strategic plan 2018-2021 consists in achieving and maintaining a CET1 ratio of around 12%.

Joana Guerreiro and Rui Constantino, Banco Santander Portugal

'The system still exhibits some vulnerabilities'

Banco Santander Portugal: We are optimising our capital structure, considering the improved economic outlook, maintaining capital ratios that preserve a comfortable buffer versus the regulatory requirements. Our sound capital position, achieved through organic capital generation, has allowed us to acquire Banco Popular Portugal and maintain an elevated CET1 capital ratio. While we aim to maintain core capital around current levels, total capital will be managed in order to comply with the subordinated MREL requirements.

Costa, CGD: Caixa's capital position has evolved very favourably over the last 18 months. As of June 2018, Caixa's CET1 was 14%, Tier 1 was 15.1%, and Total capital 16.6%, well above the minimum requirements even taking into account the phasing-in of capital buffers over the next years. This compares with 12.1% CET1 and 14.1% total capital in the beginning of 2017, just after the first phases of the recapitalisation. Capital ratios have increased due to the reduction of RWAs as well as due to the organic generation of CET1 via profits. We can expect this trend to continue for the future. Caixa does not have absolute targets for its capital ratios, but given its nature as a public company and the difficulties in allowing states to inject capital in companies due to EU State Aid rules, it is Caixa management's intention to have substantial buffers of capital at all times that will allow it to endure less favourable economic cycles without the need to go back to its shareholder to ask for more capital.

Day, BIHC: Bruno, how did CGD's Tier 2 transaction go and how did it fit into your plans?

Costa, CGD: The Tier 2 transaction was the third and last phase of the recapitalisation plan, after agreeing with DG Comp that we could complete the requirement to access private investors by issuing Tier 2 instead of AT1. The deadline to complete the recapitalisation was September 2018 (18 months after the capital injection by the state, which took place in March 2017), but given the

Rui Coimbra, Millennium bcp

volatility in the market caused by the political situation in Italy, we thought it would be wiser to anticipate the issue. We found a window in late June which, despite not being ideal, still allowed for a successful transaction very well received by the investor community.

Vincent Hoarau, CACIB: Caixa Geral's Tier 2 was a landmark trade printed in choppy markets. We were very happy to contribute to resolving the situation and reinvigorating the funding franchise in primary. The funding team and dealers demonstrated that the signature is a very credible alternative for international bonds investors.

Back in June, a level of 5.75% for the quality distribution we enjoyed was definitely an excellent result for Caixa Geral. This Tier 2 was in the pipeline for quite some time and the market window imposed was quite challenging at the end of June when we proceeded. You could still feel the scars of the violent mark to market moves and negative returns investors suffered throughout H1. Generally speaking, the volatile markets of 2018 have made the sale of subordinated debt much harder, with a lot of execution risks associated with any subordinated trade.

CGD Tier 2 is now trading well above par in early November, just shy of a 104% cash price. It has tightened by more than 75bp versus swaps since it was launched in June. Everyone should really be very happy.

Day, BIHC: What can you tell us about your issuance plans going forward, particularly with regard to any capital/subordinated activity?

Coimbra, Millennium bcp: BCP currently holds a very strong liquidity position, not having any relevant wholesale funding needs to support its core operating requirements, given that it has a loan to deposit ratio below 100%.

Recently, the bank has been notified by the Bank of Portugal of the Single Resolution Board's decision regarding the MREL for the resolution group headed by BCP, at a sub-consolidated level, which includes the operations based in Portugal, Switzerland and Cayman, and excludes the ones based in Mozambique and Poland. The MREL requirement has been set at 14.46% of the total liabilities and own funds of the Resolution Group, as of 30 June 2017 (with the prudential requirements as of 1 January 2017), which is equivalent to 26.61% of such Resolution Group´s risk-weighted assets. Moreover, the bank has been informed that the MREL requirement needs to be met by 1 July 2022.

'You could still feel the scars of the violent moves'

Additionally, in the same medium term horizon, BCP will continue to manage the composition of its capital buffers, issuing subordinated instruments to fill the applicable regulatory buckets to optimise the cost efficiency of its total buffer of own funds.

Costa, CGD: Given Caixa's very comfortable liquidity situation at the moment, any plans for future issuance will be driven exclusively by regulatory requirements. Having completed the recapitalisation, the next regulatory requirement will be MREL. We still need to hear from the SRB what will be the specific requirements for Caixa and how much time we will have to implement it. On the other hand, we also need the government in Portugal to prepare the necessary legislation that will allow us to issue senior non-preferred bonds. We don't expect to have a very significant shortfall to cover, given that the bank's RWAs will decrease further and our capital ratios will rise accordingly. In any case, we are ready to adjust our funding and capital plan in order to accommodate all the requirements we are asked to comply with over the next few years.

Donchev, CACIB: Portugal is part of the Banking Union within the EU and as such Portuguese banks are subject to the standard SRB MREL-setting methodology, which is now well understood by markets. We at CACIB expect that all Portuguese banks will receive their MREL requirements in the course of 2019 — as mentioned by Miguel, BCP recently disclosed that the SRB has determined a MREL target at the sub-consolidated level.

One particular point to note is that in our view, Portuguese banks' funding over the next one to two years is likely to be driven exclusively by prudential and MREL requirements as the banks have excess liquidity and funding via predominantly deposits and as such do not need to tap wholesale funding markets (not even for TLTRO refinancing). Hence, the public appearance of Portuguese banks in the market should benefit to some degree from rarity value.

Regarding the adoption of the Portuguese senior non-preferred law, we ex-


Christine Passieux, BNPP AM

pect Portugal to adhere to the deadline set by the EU Bank Creditor Hierarchy Directive, which mandates that all EU member states must have senior non-preferred debt introduced in national legislation by the end of 2018.

Day, BIHC: The improvement in the Portuguese situation comes while there are increasing political risks in some parts of Europe and greater episodes of volatility in financial markets. What arguments can Portuguese banks make to be positively differentiated in this more adverse environment?

Vinuela, Moody's: The funding and liquidity position of Portuguese banks stabilised in 2017 and 2018, aided by balance sheet deleveraging, while their deposit funding remained stable. As a consequence, banks have been able to reduce their loan-to-deposit ratios from the very high levels seen in 2012. We do not see funding as a constraint at the moment. Portugal's large banks have been able to raise debt in the capital markets, and their refinancing needs are limited.

Portuguese banks have around EUR20bn of exposure to the ECB's Targeted Longer Term Refinancing Operations (TLTROs), which we expect them to gradually repay between June 2020 and March 2021. The sector's TLTRO funding has declined considerably from its 2012 peak of EUR61bn. It now accounts for around 5% of Portuguese banks' assets, below the level of other European systems such as Italy and Spain.

However, we note that Portugal is more susceptible than larger European banking systems to a market shock, as yields on Portuguese banking debt are more sensitive to changes in market sentiment. In addition, the introduction of the EU's Minimum Requirement for Own Funds and Eligible Liabilities (MREL) rule, under which banks must hold minimum volumes of loss-absorbing capital, will force Portuguese banks to issue eligible financial instruments. A continued improvement of Portuguese banks' financial fundamentals will be key to ensuring that they retain affordable access to the capital markets.

Banco Santander Portugal: The Portuguese financial system is well advanced in its restructuring process, even though there are differences between entities. The gains obtained in terms of sounder capital and lower NPL ratios, within the context of a more balanced economy, clearly should contribute to a better risk perception by outside observers.

'They are far better positioned than 5 years ago'

Passieux, BNP Paribas AM: On the political front, the ruling socialist party, in power since the end of 2015, does not have a majority in parliament, and relies on the support of several smaller left-leaning parties. The government has nevertheless successfully pursued a consolidation policy, which, coupled with the gearing effects of growth, has helped improve public finances to the satisfaction of the European Commission. Despite political challenges, over the past two years, the government has successfully retained the broad support of its parliamentary alliance.

While Portuguese banks do have substantial exposure to government bonds (in line with most EU banks) the largest part is domestic and their expo-


María Vinuela, Moody's

sure outside Portugal is largely focused in international markets where Portuguese banks have been present historically (Angola, Mozambique, Macau). Exposure to Italy is not significant and, in contrast to 2011, the spillover effect from the crisis in Italy has, so far, been limited. Investors are clearly more confident about the economic trajectory of the country and the improvement in its public finances. As a result, Portuguese sovereign bonds have outperformed in 2018. Looking back to 2011, one of the key concerns that investors had about Portugal was the deadly loop between the sovereign and the banking system, each requiring the other to bail it out, resulting in a rescue package from the EU. Today, Portuguese banks, with restored capital and lower reliance on central bank funding, are benefitting from a stronger Portuguese economy and while risks remain, they are far better positioned than five years ago.

Costa, CGD: Portuguese banks went through periods of great volatility and uncertainty during the years of the Assistance Programme and learned valuable lessons. These days, Portuguese banks are better capitalised, have plenty of access to liquidity, and are taking advantage of the favourable economic environment to reduce non-performing exposures and clean up their balance sheets. Profitability may still be a challenge given the very low levels of in-

Bruno Costa, CGD

terest rates, but I'm confident the Portuguese banking system will continue to show great resilience even if market conditions worsen in the near future.

Tristan Lagarrigue, CACIB: French investors are extremely diligent and sensitive to timing, and unfortunately the ongoing noise and fluid geopolitical situations that were influencing global markets when CGD surfaced discouraged some French investors from investing in Portuguese assets. This is what everyone could read anyway when looking at the distribution statistics. Nevertheless, the overall sentiment towards the jurisdiction has been very positive for quite some time now. Our domestic investor base likes the credit story and appreciates the positive rating trajectories and evolution of the capital metrics over the last 15 months. And most of our clients have already reopened lines on Portuguese credits. I am very optimistic with regards to the expansion of Portuguese banks towards the French investor base, but also in other regions on the continent. They offer strong RV, and investors find in Portuguese assets valuable instruments to play the convergence and compression trade.

CGD's outperformance in Tier 2 proved many around us wrong. CGD's funding management made this transaction a success in spite of the mixed record in the country, with some resolution processes in the past, and paves the way for a return in force of Portuguese issuers in primary in 2019. Needless to say, what is valid for Portuguese financial borrowers — also including Santander Portugal and Millennium bcp — is also valid for corporate issuers. And in that respect, EDP's recent successes also delivered evidence of the very good shape of the jurisdiction. EDP is another credit that is very well received by French investors.

Coimbra, Millennium bcp: The increase in sovereign risk, which has escalated in the last three months, is related, more recently, to the issue of the Italian Budget for 2019 and has resulted in Moody's recent downgrade of the sovereign and Italian banks' ratings. This generates volatility in financial markets and has also some side effects on BCP shares given Portugal's dependence on the European project.

What differentiates Portugal from some other European countries is a stable overall political environment, with no significant social unrest. Portugal is ruled by a centre left-wing coalition government that is entering the last year

'The political mood has been relatively calm'

of its term of office. During this time the political mood was relatively calm. There was not much difficulty in approving the annual budgets in the Parliament and the social and labour environment was smooth, without signs of major protest movements. All the rating agencies recognise the enormous progress in fiscal consolidation and the reduction of the public debt burden. Portuguese public debt spreads have also moved in the right direction.

Portuguese banks are set to benefit from the economic recovery, volume growth in the coming years, decreases in loan delinquencies, and future increases in interest rates in Europe.

Meanwhile, BCP is improving its asset-risk indicators and steadily increasing its organic capital generation,

Tristan Lagarrigue, CACIB

as lower cost of risk levels are reflected in an improving domestic bottom line. One should also highlight the lower reliance on wholesale funding and its modest refinancing requirements as a result of its recent and successful balance sheet restructuring and deleveraging effort.

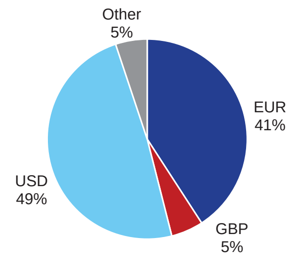
Hoarau, CACIB: In early November credit and equities have shown more resilience, but investors continue to sell into any strength, willing to offload positions and reduce balance sheet with year-end looming. In the secondary market, high beta names are being marked better — but you still need to be aggressive to hit the bid if you are trying to sell. There is no structural appetite for higher beta risk assets at present and liquidity in the subordinated space is very limited, regardless of the jurisdiction and risk profile of the signature you consider.

However, Portuguese names are doing relatively well. High beta southern European credits are more exposed to spikes in volatility, but Portuguese names have in general outperformed their peers. The rating trajectory of the Portuguese sovereign and the ongoing improvement in the banking sector continue to deliver elements of comfort to opportunistic credit investors, even if the high level picture shows a very nervous market. ●

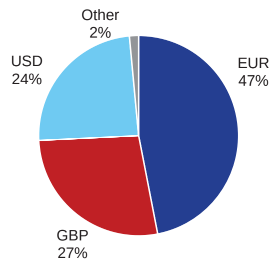
Portuguese flag photo: Montserrat Labiaga Ferrer/Wikimedia Commons

Currencies, structures and distribution

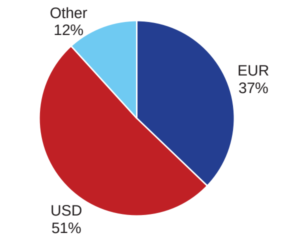
Bank hybrid issuance by currency
(2018 ytd)



Insurance issuance by currency
(2018 ytd)

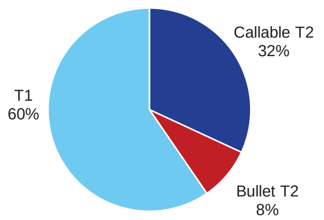


SNP/Senior HoldCo issuance by currency
(2018 ytd)

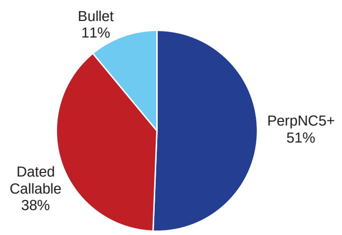


Source: Crédit Agricole CIB

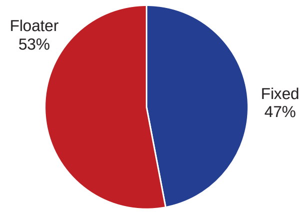
Bank issuance by instrument/structure
(2018 ytd)



Insurance issuance by instrument/structure
(2018 ytd)

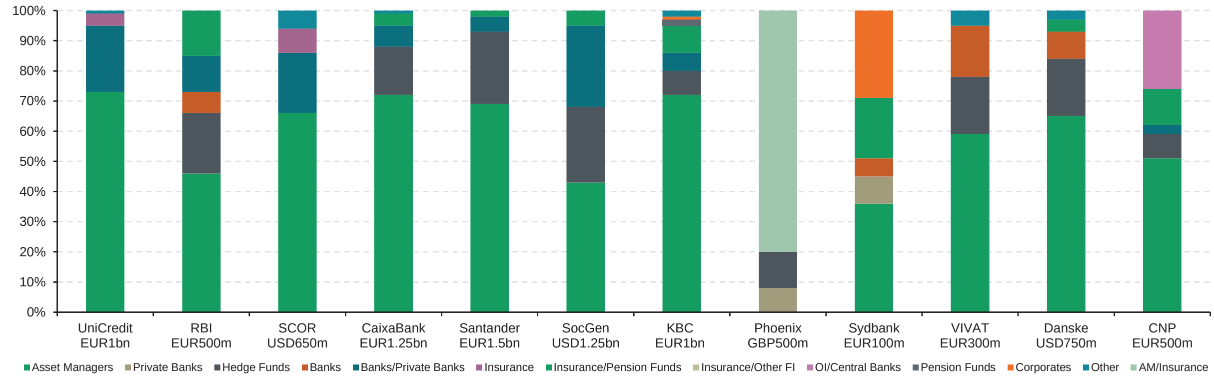


SNP/Senior HoldCo issuance by coupon
(2018 ytd)

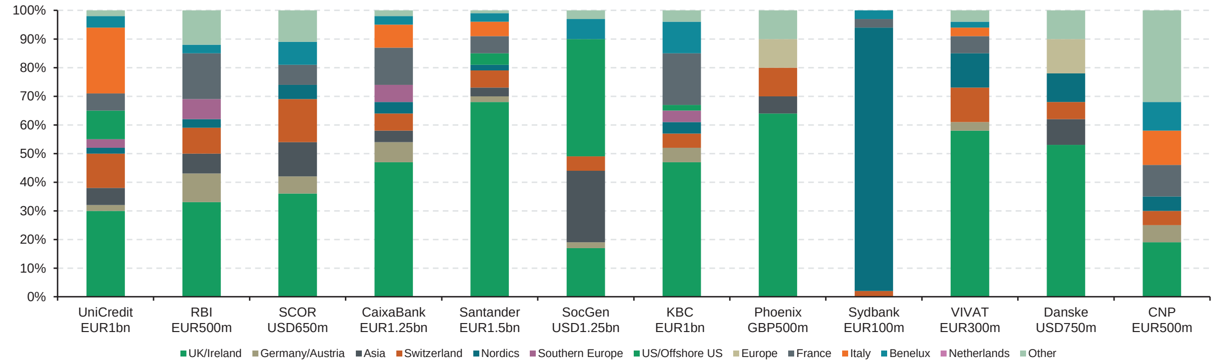


Source: Crédit Agricole CIB

Tier 1 distribution by investor type



Tier 1 distribution by geography



Source: Crédit Agricole CIB

AT1, RT1 monitoring

AT1 performance monitoring (as at 13/11/18)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	Principal loss absorption	Trigger	Price	I-Spread	Yield to call	Yield to maturity	Reset spread
05-Nov-18	SANBBZ	-/-/-	USD	1,250	7.250%	Perpetual	08-Nov-23	-	-	99.70	410	7.32	7.27	-
25-Oct-18	SCBNOR	Ba2/-/-	NOK	750	5.930%	Perpetual	29-Oct-25	-	-	100.00	-	6.03	6.03	-
23-Oct-18	SCBNOR	Ba2/-/-	NOK	750	5.930%	Perpetual	30-Oct-23	-	-	101.24	-	5.74	5.95	-
10-Oct-18	CIMBMK	-/-/-	MYR	1,000	5.400%	Perpetual	23-Oct-23	-	5.125%	101.75	111	5.00	2.51	163
02-Oct-18	LLOYDS	Baa3/BB-/BB+	USD	1,500	7.500%	Perpetual	27-Sep-25	EC	7.000%	100.37	435	7.43	7.70	450
08-Oct-18	SHNHAN	-/-/-	KRW	200,000	3.700%	Perpetual	15-Oct-23	PWD	-	-	176	-	3.71	-
27-Sep-18	SOCGEN	Ba2/BB+/-	USD	1,250	7.375%	Perpetual	04-Oct-23	TWD	5.125%	98.32	467	7.79	7.63	430
20-Sep-18	HSBC	Baa3/-/BBB	GBP	1,000	5.875%	Perpetual	28-Sep-26	EC	7.000%	100.21	427	5.84	6.01	428
18-Sep-18	BBVASM	Ba2/-/BB	EUR	1,000	5.875%	Perpetual	24-Sep-23	EC	5.125%	97.19	639	6.56	7.33	566
17-Sep-18	HSBC	Baa3/-/BBB	SGD	750	5.000%	Perpetual	24-Sep-23	EC	7.000%	100.53	255	4.88	5.30	267
12-Sep-18	ADIBUH	B1/-/-	USD	750	7.125%	Perpetual	20-Sep-23	-	-	104.02	303	6.15	7.08	427
11-Sep-18	BOCHKL	Baa2/BBB/-	USD	3,000	5.900%	Perpetual	14-Sep-23	-	-	100.08	276	5.88	6.16	304
05-Sep-18	CS	Ba2u/BB-/BB	USD	1,500	7.250%	Perpetual	12-Sep-25	PWD	7.000%	98.63	436	7.51	7.56	433
05-Sep-18	DBSSP	Baa1/-/BBB	SGD	1,000	3.980%	Perpetual	12-Sep-25	-	-	99.88	154	4.00	1.96	165
04-Sep-18	RABOBK	Baa3/-/BBB-	EUR	1,000	4.625%	Perpetual	29-Dec-25	TWD	5.125%	100.90	389	4.48	5.47	410
23-Aug-18	SHINFN	-/-/-	KRW	400,000	4.150%	Perpetual	29-Aug-23	PWD	-	95.02	237	5.55	4.43	-
16-Aug-18	OCBCSP	Baa1/BBB-/BBB	SGD	1,000	4.000%	Perpetual	24-Aug-23	PWD	-	100.68	151	3.84	4.34	181
08-Aug-18	BNP	Ba1/BBB-/BBB-	USD	750	7.000%	Perpetual	16-Aug-28	TWD	5.125%	99.28	390	7.10	7.19	398
07-Aug-18	BACR	Ba3/B+/BB+	USD	2,500	7.750%	Perpetual	15-Sep-23	EC	7.000%	99.94	472	7.76	8.08	484
24-Jul-18	CRBKMO	-/-/-	RUB	5,000	12.000%	Perpetual	16-Jan-24	-	-	-	-	-	-	-
20-Jul-18	WOORIB	-/-/-	KRW	400,000	4.400%	Perpetual	26-Jul-23	PPWD	-	-	243	-	4.41	-
13-Jul-18	MIZUHO	-/-/-	JPY	155,000	1.350%	Perpetual	15-Dec-28	-	-	99.98	106	1.35	1.01	108
13-Jul-18	MIZUHO	-/-/-	JPY	195,000	1.130%	Perpetual	15-Dec-23	-	-	100.43	95	1.04	1.01	102
09-Jul-18	CS	Ba2u/BB-/BB	USD	2,000	7.500%	Perpetual	17-Jul-23	PWD	7.000%	101.59	397	7.09	7.63	460
20-Jun-18	DANBNK	-/BB+/BB+	USD	750	7.000%	Perpetual	26-Jun-25	EC	7.000%	94.39	497	8.11	7.62	413
30-May-18	HOFISS	-/-/-	EUR	40	8.000%	Perpetual	01-Sep-23	-	5.125%	99.73	774	8.06	8.96	769
23-May-18	SYDBDC	Ba1/-/-	EUR	100	5.250%	Perpetual	25-Aug-25	PWD	7.000%	101.27	448	5.01	6.00	462
22-May-18	VORHYP	-/-/-	EUR	40	6.125%	Perpetual	28-Jun-30	TWD	7.000%	87.73	680	7.74	7.37	500
21-May-18	CFG	-/BB+/BB-	USD	300	6.000%	Perpetual	06-Jul-23	-	-	98.81	318	6.30	6.23	300
18-Apr-18	BGAV	Ba1/-/-	EUR	300	5.000%	Perpetual	14-May-25	TWD	5.125%	94.93	548	5.95	6.18	441
17-Apr-18	KBCBB	-/BB+/BB+	EUR	1,000	4.250%	Perpetual	24-Oct-25	TWD	5.125%	91.53	521	5.75	5.52	359
12-Apr-18	WESTBR	-/-/-	GBP	22	11.000%	12-Apr-38	12-Apr-33	-	-	100.00	925	11.00	11.00	-
12-Apr-18	PBBGR	-/BB-/-	EUR	300	5.750%	Perpetual	28-Apr-23	TWD	7.000%	96.05	653	6.79	7.00	538
04-Apr-18	SOCGEN	Ba2/BB+/-	USD	1,250	6.750%	Perpetual	06-Apr-28	TWD	5.125%	89.27	523	8.43	7.79	393
27-Mar-18	CAZAR	-/B-/B	EUR	350	7.000%	Perpetual	06-Apr-23	TWD	5.125%	97.76	757	7.60	8.51	681
19-Mar-18	HSBC	Baa3/-/BBB	USD	1,800	6.500%	Perpetual	23-Mar-28	EC	7.000%	95.21	402	7.21	7.01	361
19-Mar-18	HSBC	Baa3/-/BBB	USD	2,350	6.250%	Perpetual	23-Mar-23	EC	7.000%	97.97	367	6.79	6.71	345
13-Mar-18	CABKSM	Ba3u/BB/-	EUR	1,250	5.250%	Perpetual	23-Mar-26	EC	5.125%	92.79	598	6.49	6.50	450
12-Mar-18	ITAU	B2/-/B	USD	750	6.500%	Perpetual	19-Mar-23	PWD	5.125%	97.50	406	7.18	7.12	386
12-Mar-18	SANTAN	Ba1/-/-	EUR	1,500	4.750%	Perpetual	19-Mar-25	EC	5.125%	88.28	671	7.06	6.36	491
27-Feb-18	HBAN	Baa3/BB+/BB	USD	500	5.700%	Perpetual	15-Apr-23	-	-	97.12	339	6.45	6.18	288
12-Feb-18	ALBRK	-/-/-	USD	205	10.000%	Perpetual	20-Feb-23	-	-	102.50	615	9.27	10.14	733
25-Jan-18	CCBGBB	Ba2/BB+/-	EUR	500	3.625%	Perpetual	16-Apr-25	TWD	5.125%	82.24	670	7.12	5.36	294
24-Jan-18	UBS	Ba1u/BB/BBB-	USD	2,000	5.000%	Perpetual	31-Jan-23	PWD	7.000%	86.52	567	8.98	6.26	243
25-Jan-18	ALFARU	B2/-/B	USD	500	6.950%	Perpetual	30-Apr-23	PWD	5.125%	84.00	865	11.60	9.09	457

Principal loss absorption: CE = conversion into equity; TWD = temporary write-down; PWD = permanent write-down

RT1 performance monitoring (as at 13/11/18)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	Principal loss absorption	Price	I-Spread	Yield to call	Yield to maturity	Reset spread
05-Sep-18	ROTHLF	-/-/BBB-	GBP	350	6.875%	Perpetual	12-Sep-28	PWD	96.88	568	7.32	7.30	542
20-Jun-18	CNPFP	Baa3/BBB-/-	EUR	500	4.750%	Perpetual	27-Jun-28	TWD	97.00	429	5.15	5.50	391
13-Jun-18	VIVATN	-/-/BB-	EUR	300	7.000%	Perpetual	19-Jun-25	PWD	107.68	510	5.59	7.02	646
19-Apr-18	PHNXLN	-/-/BBB-	GBP	500	5.750%	Perpetual	26-Apr-28	PWD	87.39	602	7.65	6.74	417
06-Mar-18	SCOR	Baa1u/A-/-	USD	625	5.250%	Perpetual	13-Mar-29	TWD	84.46	422	7.43	6.41	237
01-Dec-17	DLGLN	Ba1u/BB/-	GBP	350	4.750%	Perpetual	07-Dec-27	EC	84.28	552	7.14	5.97	339
12-Oct-17	ASRNED	-/BB/-	EUR	300	4.625%	Perpetual	19-Oct-27	EC	93.35	481	5.58	5.62	379

Source: Crédit Agricole CIB

Tier 2 bank, insurance hybrids

Bank Tier 2 performance monitoring (as at 13/11/18)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	I-Spread	Yield to call	Yield to maturity	Reset spread
19-Nov-18	CHINAM	-/-/-	CNY	20,000	0.000%	19-Nov-28	19-Nov-23	-	-	-	-
05-Nov-18	SANBBZ	-/-/-	USD	1,250	6.125%	08-Nov-28	08-Nov-23	293	6.15	6.14	-
30-Oct-18	INBKIN	-/-/-	INR	2,900	8.900%	30-Oct-28	-	-	-	-	-
31-Oct-18	CITNAT	-/-/-	KRW	300,000	2.960%	06-Nov-28	-	85	-	2.89	-
17-Oct-18	SOCGEN	Baa3/BBB/A-	JPY	13,100	1.250%	24-Oct-28	24-Oct-23	110	1.18	1.37	110
22-Oct-18	CINDBK	-/-/-	CNY	20,000	4.800%	22-Oct-28	22-Oct-23	157	4.78	4.73	-
10-Oct-18	BNP	Baa2/BBB+/-	JPY	9,000	1.104%	18-Oct-28	18-Oct-23	94	1.02	1.19	90
02-Oct-18	BMO	Baa1/BBB+/A+	USD	850	4.338%	05-Oct-28	05-Oct-23	144	4.56	4.57	128
11-Oct-18	BCHINA	-/-/-	CNY	40,000	4.840%	11-Oct-28	11-Oct-23	151	4.90	4.82	-
20-Sep-18	BSMXB	Baa3/-/BBB-	USD	1,300	5.950%	01-Oct-28	01-Oct-23	304	6.16	6.22	300
19-Sep-18	NDASS	Baa1/A-/A+	SEK	1,750	1.022%	26-Sep-28	26-Sep-23	-	1.05	0.99	-
25-Sep-18	CCB	-/-/-	CNY	43,000	4.860%	25-Sep-28	25-Sep-23	152	4.90	4.82	-
20-Sep-18	BCOMFL	-/-/-	CNY	2,000	5.150%	20-Sep-28	20-Sep-23	164	4.81	4.96	-
13-Sep-18	CINDBK	-/-/-	CNY	30,000	4.960%	13-Sep-28	13-Sep-23	158	4.78	4.80	-
30-Aug-18	CIMBMK	-/-/-	MYR	1,200	4.880%	13-Sep-29	13-Sep-24	88	4.81	4.84	-
05-Sep-18	BCHINA	-/-/-	CNY	40,000	4.860%	05-Sep-28	05-Sep-23	153	4.90	4.82	-
28-Aug-18	SHBASS	A3/A-/AA-	EUR	750	1.625%	05-Mar-29	05-Mar-24	133	1.72	2.27	127
17-Jul-18	WOORIB	-/-/-	KRW	160,000	2.200%	18-Jul-20	-	26	-	2.11	-
13-Jul-18	UOBKMY	-/-/-	MYR	600	4.800%	25-Jul-28	25-Jul-23	81	4.68	4.73	-
11-Jul-18	ACAFP	Baa2/BBB+/A	JPY	8,300	1.250%	18-Jul-28	18-Jul-23	100	1.08	1.31	111
26-Jun-18	ACAFP	-/BBB+/A	JPY	46,400	1.504%	12-Jul-28	-	127	-	1.54	-
25-Jun-18	SWEDA	Baa1/A-/-	JPY	11,000	0.950%	29-Jun-28	29-Jun-23	90	0.97	1.14	85
21-Jun-18	CXGD	Ba3/-/B+	EUR	500	5.750%	28-Jun-28	28-Jun-23	448	4.77	5.78	550
18-Jun-18	MTROLN	-/-/-	GBP	250	5.500%	26-Jun-28	26-Jun-23	680	8.22	7.36	446
18-Jun-18	DBSSP	A3 *+/-/A+	JPY	7,300	0.850%	25-Jun-28	25-Jun-23	91	0.98	1.09	74
08-Jun-18	PSSPO	-/-/-	EUR	15	2.132%	15-Jun-28	-	-	-	1.94	-
29-May-18	AASLN	-/-/-	GBP	37	2.250%	31-May-25	-	90	-	2.42	-
04-Jun-18	DBSSP	A3 *+/-/A+	USD	750	4.520%	11-Dec-28	11-Dec-23	127	4.40	4.61	159
23-May-18	OAKNBK	-/-/-	GBP	50	7.750%	01-Jun-28	01-Jun-23	-	-	-	685
16-May-18	BBVASM	Baa3/BBB/BBB+	USD	300	5.250%	29-May-33	-	235	-	5.61	-
08-May-18	DBSSP	A3 *+/-/A+	CNY	950	5.250%	15-May-28	15-May-23	100	5.37	5.32	-
07-May-18	LBBW	Baa2/-/BBB	AUD	450	5.000%	17-May-28	-	227	-	5.03	-
26-Apr-18	SWEDA	Baa1/A-/A+	SEK	1,200	1.588%	08-May-28	08-May-23	141	1.92	2.40	103
18-Apr-18	BGASJ	Ba2/-/BB	USD	400	6.250%	25-Apr-28	25-Apr-23	464	7.75	7.32	352
18-Apr-18	LEED	Baa2/-/BBB+	GBP	200	3.750%	25-Apr-29	25-Apr-28	310	4.73	4.69	229

Insurance Tier 2 performance monitoring (as at 13/11/18)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	I-Spread	Yield to call	Yield to maturity	Reset spread
07-Nov-18	LGEN	A3/BBB+/-	GBP	400	5.125%	14-Nov-48	14-Nov-28	358	5.22	5.38	465
19-Sep-18	PHNXLN	-/-/BBB	EUR	500	4.375%	24-Jan-29	-	419	-	5.16	-
14-Sep-18	PICORP	-/-/BBB+	GBP	350	5.625%	20-Sep-30	-	422	-	5.92	-
31-Aug-18	MAPSM	-/-/BBB-	EUR	500	4.125%	07-Sep-48	07-Sep-28	320	4.14	5.20	430
29-Aug-18	ASAMLI	-/-/BB	USD	430	6.500%	Perpetual	05-Sep-23	417	7.29	7.68	458.8
10-Jul-18	LIFEVT	Baa1/A-/-	USD	372	5.250%	19-Jul-68	19-Jul-48	244	5.71	5.78	331.4
04-Jul-18	VITTAS	-/-/BBB-	EUR	250	5.750%	11-Jul-28	-	488	-	5.80	-
14-May-18	KHLIIN	-/-/BB	USD	200	7.500%	21-May-48	21-May-23	556	8.68	8.19	465.8
19-Apr-18	MYLIFE	A3/BBB+/-	USD	1,000	5.100%	26-Apr-48	26-Apr-28	201	5.20	5.83	315
17-Apr-18	ZURNVX	A2/A/A-u	USD	500	5.125%	01-Jun-48	01-Jun-28	247	5.74	6.06	326.5
16-Apr-18	HLINSU	A3/-/A-	USD	1,000	4.700%	23-Apr-48	23-Apr-23	268	5.80	5.44	326.5
04-Apr-18	AEGON	Baa1/BBB/BBB-	USD	800	5.500%	11-Apr-48	11-Apr-28	304	6.23	6.51	354
22-Mar-18	AIZ	Ba1/BB+/-	USD	400	7.000%	27-Mar-48	27-Mar-28	377	6.97	7.20	413.5
21-Mar-18	AXASA	A3/BBB+/BBB	EUR	2,000	3.250%	28-May-49	28-May-29	265	3.66	4.39	320
21-Mar-18	STBNO	-/BBB/-	SEK	900	2.121%	27-Mar-48	27-Mar-25	-	2.30	2.70	-
22-Feb-18	USIMIT	Ba2/-/BB+	EUR	500	3.875%	01-Mar-28	-	556	-	6.45	-
25-Jan-18	FWDINS	Ba2/-/BB+	USD	200	5.500%	Perpetual	01-Feb-23	518	8.30	6.76	307.5
22-Jan-18	ACAFP	-/BBB/-	EUR	1,000	2.625%	29-Jan-48	29-Jan-28	308	3.96	4.29	265
12-Jan-18	LAMON	-/BBB/-	USD	310	4.800%	18-Jan-48	18-Jan-28	393	7.12	6.85	323.5
14-Dec-17	LAMON	-/BBB/-	USD	400	4.800%	21-Dec-47	21-Dec-27	398	7.16	6.98	344
05-Dec-17	CASSIM	-/BB+/-	EUR	500	4.250%	14-Dec-47	14-Dec-27	518	6.04	6.05	445.5

Source: Crédit Agricole CIB

SNP, HoldCo issuance

SNP performance monitoring (as at 13/11/18)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	I-Spread	Yield to maturity
16-Oct-18	CMZB	Baa1/BBB/BBB+e	EUR	500	1.250%	23-Oct-23	95	1.29
17-Oct-18	CABKSM	Ba1/BBB/BBB+	EUR	1,000	1.750%	24-Oct-23	148	1.83
24-Sep-18	SOCGEN	Baa2/BBB+/A	EUR	1,250	2.125%	27-Sep-28	128	2.23
22-Aug-18	RABOBK	A3/A-/AA-	EUR	1,000	0.750%	29-Aug-23	47	0.79
04-Jul-18	FRLBP	-/BBB/A-	EUR	750	2.000%	13-Jul-28	106	1.98
15-Jun-18	NDASS	Baa1/A/AA-	EUR	1,000	0.875%	26-Jun-23	72	1.01
05-Jun-18	DANBNK	Baa2/BBB+/A	USD	400	3.394%	12-Sep-23	-	4.29
05-Jun-18	DANBNK	Baa2/BBB+/A	USD	850	3.875%	12-Sep-23	145	4.57
05-Jun-18	DANBNK	Baa2/BBB+/A	USD	500	4.375%	12-Jun-28	176	4.96
18-May-18	DANBNK	Baa2/BBB+/A	SEK	2,000	0.245%	25-Jan-23	-	1.08
18-May-18	DANBNK	Baa2/BBB+/A	SEK	2,250	1.125%	25-Jan-23	161	2.07
14-May-18	DANBNK	Baa2/BBB+/A	EUR	1,250	0.875%	22-May-23	120	1.48
03-May-18	BBVASM	Baa2/BBB+/A-	EUR	1,000	1.375%	14-May-25	120	1.76
10-Apr-18	BNP	Baa1/A-/A+	EUR	500	1.000%	17-Apr-24	88	1.29
12-Mar-18	BPCEGP	Baa2/A-/A	EUR	750	1.375%	23-Mar-26	101	1.68
12-Mar-18	BPCEGP	Baa2/A-/A	EUR	950	0.181%	23-Mar-23	-	0.51
06-Mar-18	ACAFP	Baa2/A-/A+	EUR	1,000	1.375%	13-Mar-25	92	1.46
01-Mar-18	NWIDE	Baa1/BBB+/A	EUR	1,000	1.500%	08-Mar-26	137	1.97
26-Feb-18	ACAFP	Baa2/A-/A+	EUR	1,250	0.281%	06-Mar-23	-	0.53
22-Jan-18	BPCEGP	Baa2/A-/A	EUR	750	1.625%	31-Jan-28	94	1.82
22-Jan-18	BPCEGP	Baa2/A-/A	EUR	1,000	0.875%	31-Jan-24	84	1.22
16-Jan-18	BNP	Baa1/A-/A+	EUR	500	0.012%	19-Jan-23	-	0.45
16-Jan-18	SOCGEN	Baa2/BBB+/A	EUR	1,250	1.125%	23-Jan-25	108	1.60
09-Jan-18	DB	Baa3/BBB-/BBB+	GBP	300	1.750%	16-Dec-21	146	2.77
09-Jan-18	DB	Baa3/BBB-/BBB+	EUR	1,250	1.750%	17-Jan-28	202	2.90
09-Jan-18	DB	Baa3/BBB-/BBB+	EUR	1,250	0.375%	18-Jan-21	124	1.15
04-Jan-18	BNP	Baa1/A-/A+	EUR	1,250	1.125%	11-Jun-26	104	1.74
02-Jan-18	BNP	Baa1/A-/A+	USD	2,000	3.375%	09-Jan-25	148	4.61
01-Dec-17	SANTAN	Baa1/A-/A-	JPY	83,700	0.568%	11-Jan-23	74	0.81

HoldCo performance monitoring (as at 13/11/18)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	I-Spread	Yield to maturity
02-Nov-18	UBS	-/A-/A+	JPY	130,000	0.719%	08-Nov-24	08-Nov-23	-	-
23-Oct-18	WFC	A2/A-/-	USD	100	5.000%	26-Oct-28	-	88	4.08
17-Oct-18	SANTAN	Baa1/A-/A-	EUR	160	2.630%	24-Oct-30	-	137	2.50
17-Oct-18	MUFG	A1/-/-	EUR	100	1.710%	25-Oct-28	-	82	1.78
10-Oct-18	SUMIBK	A1/A-/-	USD	1,000	3.936%	16-Oct-23	-	66	3.78
10-Oct-18	SUMIBK	A1/A-/-	USD	850	3.236%	16-Oct-23	-	-	3.41
10-Oct-18	SUMIBK	A1/A-/-	USD	650	4.306%	16-Oct-28	-	102	4.22
09-Oct-18	CS	-/-/-	USD	100	0.000%	26-Oct-48	26-Oct-23	203	5.29
04-Oct-18	AIB	Baa3/BB+/BBB-	USD	750	4.750%	12-Oct-23	-	170	4.82
04-Oct-18	MIZUHO	A1/A-/-	EUR	500	1.020%	11-Oct-23	-	55	0.89
04-Oct-18	AIB	Baa3/BB+/BBB-	USD	750	4.750%	12-Oct-23	-	169	4.81
01-Oct-18	RY	A2/A/AA	USD	1,500	3.700%	05-Oct-23	-	75	3.87
01-Oct-18	RY	A2/A/Ae	USD	300	3.068%	05-Oct-23	-	-	3.41
01-Oct-18	MUFG	A1/A-/A	EUR	500	0.980%	09-Oct-23	-	57	0.91
27-Sep-18	STANLN	A2/BBB+/A	USD	600	3.558%	20-Jan-23	20-Jan-22	-	3.78
27-Sep-18	STANLN	A2/BBB+/A	USD	1,400	4.247%	20-Jan-23	20-Jan-22	124	4.33
27-Sep-18	STANLN	A2/BBB+/A	USD	1,400	4.247%	20-Jan-23	20-Jan-22	120	4.30
27-Sep-18	STANLN	A2/BBB+/A	USD	600	3.558%	20-Jan-23	20-Jan-22	-	3.75
25-Sep-18	INTNED	Baa1/A-/A+	USD	1,250	4.550%	02-Oct-28	-	155	4.75
25-Sep-18	INTNED	Baa1/A-/A+	USD	1,500	4.100%	02-Oct-23	-	111	4.23
25-Sep-18	INTNED	Baa1/A-/A+	USD	500	3.398%	02-Oct-23	-	-	3.68
24-Sep-18	RBS	Baa2/BBB-/BBB+	USD	1,750	5.076%	27-Jan-30	27-Jan-29	204	5.25
19-Sep-18	BANQUE	Baa3u/BBB/BBB+	EUR	300	1.500%	28-Sep-23	-	147	1.80
26-Jun-18	AIB	Baa3/BB+/BBB-	EUR	500	2.250%	03-Jul-25	-	175	2.33
20-Jun-18	RBS	Baa2/BBB-/BBB+	USD	1,250	4.519%	25-Jun-24	25-Jun-23	165	4.76
20-Jun-18	RBS	Baa2/BBB-/BBB+	USD	750	3.923%	25-Jun-24	25-Jun-23	-	4.12

Source: Crédit Agricole CIB

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